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ABSTRACT

This guide is intended to provide guidance to state and local leaders in identifying the need for finance reform; understanding and evaluating the pros and cons of alternative financial approaches; and designing strategies to build long-lasting public support. Chapter 1 reviews the key forces pushing for reform and outlines principles to guide reform. Chapters 2 through 5 describe an array of policy options for state and local reformers across four critical and interrelated areas of finance: revenue generation, budgeting, partnerships, and financial and other incentives. Chapter 6 offers approaches to build the public and political support for change. Each chapter contains references. Two appendices list the members of the Finance Project's national review and advisory panel and the working groups. (KB)

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A GUIDE to FINANCING QUALITY EDUCATION and OTHER CHILDREN'S SERVICES

PS 026 929

THE FINANCE PROJECT

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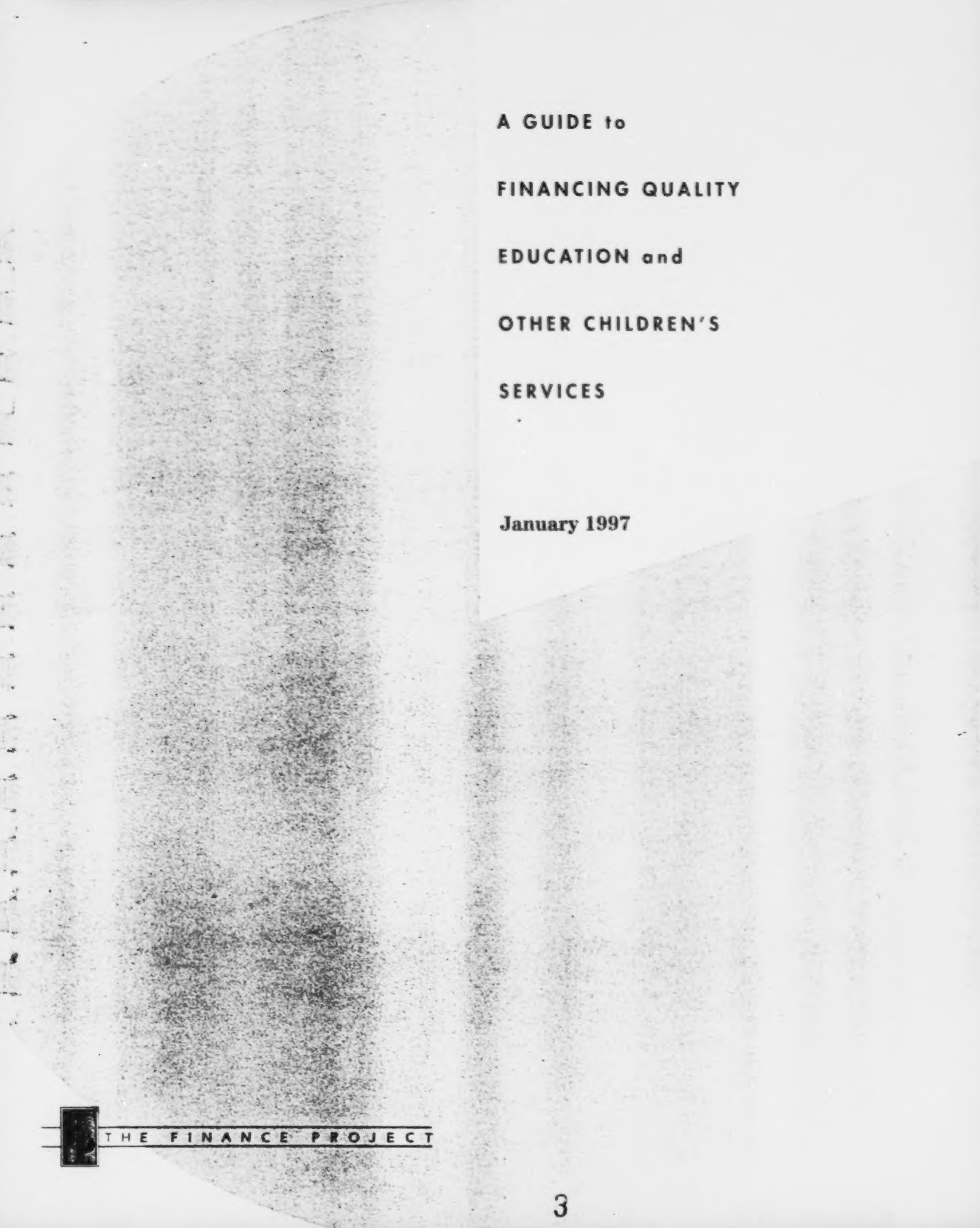
MONEY MATTERS

A GUIDE to FINANCING QUALITY EDUCATION and OTHER CHILDREN'S SERVICES

January 1997



THE FINANCE PROJECT

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ABOUT THE FINANCE PROJECT

The Finance Project is a national initiative to improve the effectiveness, efficiency, and equity of public financing for education and other children's services. With leadership and support from a consortium of private foundations, The Finance Project was established in 1994 as an independent, nonprofit organization. It undertakes an ambitious array of policy research and development activities, policymaker forums and public education activities, as well as support and technical assistance activities.

The work of The Finance Project is aimed at increasing knowledge and strengthening the capability of communities, states, and the federal government to implement promising strategies for generating necessary fiscal resources and improving the return on investments in children and their families. Its activities are intended to:

- Examine the ways in which governments at all levels finance public education and other supports and services for children (age 0-18) and their families;
- Identify and highlight structural and regulatory barriers that impede the effectiveness of programs, institutions, and services, as well as other public investments, aimed at promoting children's growth and development;
- Outline the characteristics of financing strategies and related structural and administrative arrangements that support improvements in education and other children's services;
- Identify promising approaches for implementing these financing strategies at the federal, state, and local levels and assess their costs, benefits, and feasibility;
- Highlight the necessary steps and cost requirements of converting to new financing strategies; and
- Strengthen intellectual, technical, and political capability to initiate major long-term reform and restructuring of public financing systems, as well as interim steps to overcome inefficiencies and inequities within current systems.

The Finance Project extends the work of many other organizations and blue-ribbon groups that have presented bold agendas for improving supports and services for children and families. It is creating the vision for a more rational approach to generating and investing public resources in education, other supports and services for children and families, and community development. It is developing ideas, options, and policy tools to actively foster positive change through broad-based systemic reform, as well as through more incremental steps to improve the effectiveness, efficiency, and equity of current systems. It also provides support and technical assistance to "reform ready" states and communities engaged in efforts to align their financing systems with their policy and program reform agendas.

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PREFACE

Public financing for education and an array of other children's services has become a topic of significant interest and political concern. Growing skepticism among a critical mass of American voters and taxpayers has fueled doubts about the ability of government to solve social problems and to provide basic supports and services that enhance the quality of life in their communities. Many believe that government is too big; it's too expensive; and it doesn't work very well.

Despite steadily increasing public expenditures for health, education, welfare, human services, and public safety over the past two decades, seemingly intractable problems persist. Nearly a quarter of U.S. children are poor and live in families and communities that are unable to meet their basic needs. Schools have become increasingly expensive, but student achievement hasn't matched the rising costs, and drop-out rates remain unacceptably high. Health care costs continue to go up. Yet, many Americans can't get the services they need, and with each passing year their health care dollars buy less. Criminal justice demands a dramatically increasing share of public dollars—for police officers and judges and jails—but neighborhood streets aren't safer.

Voters have spoken clearly. They want more for their money. They have called for more and better services and a sharper focus on economic development and job creation, but they also have demanded balanced budgets and cuts in income and property taxes. In this time of big public deficits, they want government at all levels to operate more effectively and efficiently. They also want it to invest wisely and to live within its means.

Fueled by these concerns, state and local leaders across the country are seeking new and innovative methods for financing education, health, and human services. They want new information and ideas on how to generate funds, budget more effectively, establish and implement effective partnerships, design fair grants, and implement programs that produce results by encouraging performance. They want to learn from other states and communities that have taken similar steps. And they want to secure the political and public support that is needed to make these initiatives succeed.

In the wake of federal welfare reform, these information needs take on special importance. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 will consolidate numerous categorical public welfare programs and provide aid to states in the form of block grants. States will have much greater discretion to decide how services will be configured and how federal aid will be spent. Beyond funding programs to assist poor children and families, states are expected to place much more attention on workforce development and the creation of new jobs. In this context, many states will see welfare reform and the new flexibility it offers as an opportunity to improve their systems for financing education, health care, and community supports and services, in order to improve the lives and future prospects of children and their families.

Money Matters seeks to guide state and local leaders in their efforts to enact meaningful finance reforms. It is intended to serve as a user-friendly resource for governors, legislators, mayors, city council members, county executives, school superintendents, human service providers, foundation executives, community activists, concerned parents and others.

Taken together, the guide's six chapters provide guidance to state and local leaders in identifying the need for reform; understanding and evaluating the pros and cons of alternative approaches; and designing strategies to build long-lasting support. Chapter 1 outlines principles to guide reform. Chapters 2 to 5 describe an array of policy options for state and local reformers across four critical and interrelated areas of finance: revenue generation, budgeting, partnerships, and financial and other incentives. Finally, Chapter 6 offers approaches to build the public and political support for change.

The guide is the product of The Finance Project's three working groups—the Working Group on Strategies for Generating Revenue for Education and Other Children's Services; the Working Group on Results-Based Planning, Budgeting, Management, and Accountability Systems; and the Working Group on Financing Comprehensive, Community-Based Support Systems. Over the past two years, these interdisciplinary development and design teams have conducted an ambitious agenda of policy research and development activities in order to increase knowledge and produce policy tools that strengthen the capability of state and local governments to improve finance systems.

Numerous individuals contributed to the development of the guide. Special thanks are due to the members of The Finance Project's three working groups and Martin E. Orland, formerly a Senior Fellow with The Finance Project, for their help in conceptualizing the project, giving it direction, and reviewing successive drafts. Thanks are also due to those who played a role in drafting and reviewing the sections of the guide. Initial chapter drafts were prepared by: Carol E. Cohen, a Senior Research Associate with The Finance Project (Chapter 1: *Background and Guiding Principles*); John L. Mikesell, Professor at the School of Public and Environmental Affairs at Indiana University, Bloomington (Chapter 2: *Generating Revenue*); Alexandra G. Tan, a Research Associate at The Finance Project (Executive Summary, first half of Chapter 3: *Budgeting Better*, and Chapter 4: *Developing Partnerships*); Barbara Dyer, of The Public's Work (second half of Chapter 3: *Budgeting Better*, and Chapter 5: *Aligning Incentives*) and; Sue Foster, currently Vice President and Director of Policy Research and Analysis at the National Center on Addiction and Substance Abuse (Chapter 6: *Building Support for Finance Reform*).

The guide benefited significantly from the efforts of several individuals to ensure that the presentation of information and ideas is clear and accessible: Carol E. Cohen; Jason Juffras, Senior Research Associate at The Finance Project; and Alexandra G. Tan devoted substantial time and energy to making the material easy to understand. Carol Cohen managed the project in its initial stages, while Alexandra Tan took over this role in the project's final stages. Ruth W. Chacon and Gloria L. Whitman, formerly with Global Marketing Strategies, provided writing, editing, and design assistance, and Scott Miller edited the report's final draft. Finally, Alicia Neering and Roneith E. Hibbert provided extremely valuable assistance in gathering relevant information, entering in editorial changes, and indexing the material.

A preliminary draft of the guide was shared widely with federal and state leaders, front-line service providers, educators, and children's advocates. We are enormously grateful to all of these individuals for their thoughtful comments and suggestions. Their help was invaluable in crafting a final product that we hope will make the task of many state and local leaders across the country a bit easier.

Cheryl D. Hayes
Executive Director

State and local leaders across the country are working to quickly and radically restructure programs for children and families. Because *money matters*, governors, mayors, state legislators, child advocates, and other concerned individuals are seeking information and ideas about how to improve finance systems for education, health, and other children's services.

These concerned state and local leaders are being encouraged by their neighbors, friends, and supporters who consistently express solid support for strengthening our nation's schools and ensuring that children receive the essentials needed to learn, grow, and develop. Yet public demands to contain and even reduce public spending for social supports and services have led state and local leaders to work under tightening fiscal pressures. In addition, the new federal law to overhaul the nation's welfare system has compounded the challenges to serving children and their families, and rebuilding communities.

In order to meet these challenges, state and local leaders want information and ideas about how to generate revenues efficiently and effectively, and how to allocate and budget resources well. They want to know how to structure partnerships between levels of government and between the public and private sectors in order to best mobilize resources for children and their families. And they want to learn more about how to align program and financial incentives to improve results for children, families, and the communities in which they live.

State and local leaders are eager to learn from others. They want new ideas about how to do business differently, information on what works, and help in adapting reform strategies to fit their own needs, priorities, and conditions. This guide is intended as a resource to help them in this endeavor.

A GUIDE TO FINANCING QUALITY EDUCATION AND OTHER CHILDREN'S SERVICES

Money Matters seeks to assist state and local leaders—including legislators, program administrators, child advocates, and others—to understand and take steps to improve financing of education and other services for children. Because many members of these groups are not experts in the details of finance, *Money Matters* provides an easily understandable tool. It lays out a series of options, choices, and possible approaches for leaders to consider as they grapple with the challenges facing their states and communities. It also provides ideas on how to mobilize the public and its leaders to support these efforts.

Information and ideas are organized in six chapters. Chapter 1, the cornerstone of the report, lays out a set of interrelated principles that should guide a state's and a community's finance reforms. Chapters 2 through 5 provide specific guidance in four critical areas: revenue generation, budgeting, intergovernmental and public-private partnerships, and financial and other incentives. Organized around broad strategies for reform, each of these chapters presents numerous options for consideration. Chapter 6 completes the guide. Designed to aid reformers who are trying to implement reforms in all of these areas, it outlines cross-cutting strategies and ideas to help state and local leaders build a strong base of political and public support for change.

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In addition to discussions of the relative advantages and disadvantages of different options for reform, the guide presents relevant examples of state and local experiences. Although these examples represent only a small fraction of the innovations that are burgeoning around the country, they provide some insight into the practical experiences of states and communities that have pursued these strategies. The guide also highlights additional written and organizational resources that may assist state and local leaders in improving finance systems.

HOW TO USE MONEY MATTERS: A KEY

Each chapter of *Money Matters* presents information and ideas under several headings to assist readers in understanding and developing reforms. They are:

- **Overview.** Located at the front of the chapter, these sections sum up the chapter's contents.
- **Background.** These sections outline major issues and trends that are compelling change. They can assist states and localities in understanding the current situation when considering which strategies to pursue.
- **Strategies.** These sections present broad reform directions and provide a framework for the chapter's options for finance reform.
- **Options, Choices, or Approaches.** The essential thrust of this document, these sections provide ideas that can be implemented by state and local policymakers. The experiences, implications, and lessons learned from other state and local governments pursuing these options are also presented through numerous examples. These sections are marked throughout the text by the ▼ symbol.
- **Summary.** Located at the end of the chapter, these sections provide a more detailed encapsulation than the chapter overviews.
- **Additional Resources.** The resource lists are organized around the major topics covered in the chapter. They include references to written materials, as well as to organizations that may be contacted for additional information. They are conveniently located at the back of each chapter.

In addition, *chapter tabs* that mark the beginning of each chapter and an *index* of key topics at the end of the guide are designed to help readers access relevant information easily.

BUILDING A SOLID FOUNDATION: GUIDING PRINCIPLES

Chapter 1: *Background and Guiding Principles* lays the cornerstone for *Money Matters*. It begins by reviewing the key economic, demographic, political, and other contextual forces that are compelling state and local leaders to search for new ways of financing education and other children's services—including increases in student populations and the needs of children and families; a changing economic context; reduced federal support, despite persistent federal requirements; and public demands for smaller government.

To assist state and local leaders responding to these pressures, the chapter highlights a set of principles that should guide finance reform. Finance systems should:

- *Keep pace with change*, adapting to current economic, demographic, and technological realities.
- *Be robust*, to ensure a stable and supportive foundation for children and families, even in adverse circumstances.

- *Enhance coordination of services*, to be sure that resources are used efficiently and meet the interrelated needs of children and families.
- *Be equitable*, promoting fair opportunities for children to learn and grow, and distributing tax burdens in a reasonable and acceptable manner.
- *Be geared to achieve results*, to make sure that funds for children and their families are well spent.
- *Reflect an appropriate balance of government and private roles*, recognizing the relative strengths of each in financing services for children and their families.
- *Be responsive to the public*, reflecting their needs and priorities, and engaging parents, taxpayers, and others in reform efforts.

Taken together, these principles should guide state and community leaders as they consider reforms in four broad areas: revenue generation; budgeting; partnerships among levels of government and between the public and private sectors; and financial and other incentives. These principles should also provide basic criteria against which new approaches are evaluated.

POLICY OPTIONS AND CHOICES: FOUR AREAS OF FINANCE

The programs and services available to children and their families are influenced by multiple factors. For example, how resources are generated and channeled to schools, hospitals, health care organizations, human service providers, and community development initiatives plays a important role in sustaining these supports and services. How services are provided helps to determine who benefits from them. How state and local leaders define investment priorities and performance incentives guide how educators, health and human service providers, and others do their jobs.

Four broad areas of finance offer promising opportunities for improvement. Chapters 2 through 5 describe options in these general areas of finance to improve the outlook for children's services. The chapters and the corresponding areas explored are:

- Chapter 2: *Generating Revenue;*
- Chapter 3: *Budgeting Better;*
- Chapter 4: *Developing Partnerships;* and
- Chapter 5: *Aligning Incentives.*

▼ Generating Revenue

Making state and local revenue generation systems more productive, fair, and efficient is one focus of efforts to improve education, health, and other children's services. Although revenue systems are often viewed separately from education, health, and human service systems, their design features have important consequences for these services. Revenue system design affects the very well-being of these systems: the amount of revenue available; the stability, predictability, and growth of these funds; and, ultimately, the public's overall acceptance of the entire system.

Several strategies are relevant to these efforts to improve revenue generation systems. As presented in Chapter 2: *Generating Revenue*, they are:

- *Broadening existing tax bases.* Legislative action and inaction have eroded major tax bases over time. Important opportunities exist for improving revenue generation systems, in the sales, income, and property tax areas. For example, expanding the sales tax to include those goods or services that currently are exempt is an important option for consideration. States can also re-evaluate ties between state and federal income tax systems, or various options to limit losses from property tax revenues.

- *Keeping pace with economic and demographic changes.* Some state and local governments have failed to make the structural and administrative changes necessary in order to adapt to important economic and demographic shifts. Realigning revenue systems in response to these changes can make the systems more equitable, efficient, and effective. Options include expanding taxes on interstate commerce; maintaining parity between property tax assessments and current market values; and re-examining tax incentives for businesses. Taxing multistate and multinational companies, as well as evolving industries, also presents options.
- *Diversifying and balancing revenue systems.* Strategies that reduce abnormal reliance on any revenue source hold many advantages for funding education and other children's services. They can minimize economic distortions, provide more stable revenue, and distribute the responsibility for funding government services more fairly. Major options include: reducing over-reliance on major tax sources; expanding the use of non-traditional local revenues; or using lottery proceeds, fees for services, and other non-tax revenue sources.
- *Making more efficient use of tax relief mechanisms.* Many states and communities grant tax relief from the major taxes to various groups. Opportunities exist to better target this relief to those in need, thereby preserving revenues and increasing fairness. The options discussed include tying property tax relief to family income, or restructuring income tax subsidies to target low-income families and individuals. Changing sales tax systems in order to rely more heavily on targeted tax credits rather than broad exemptions can also be considered.

The programs and services available to children and their families are influenced by multiple factors—how resources are generated and channeled, how services are provided, and how state and local leaders define investment priorities and performance incentives.

▼ Budgeting Better

The process of budgeting resources assumes a significant role in finance systems for education, health, and other children's services. Well-functioning budgeting policies and procedures influence not only the amounts of resources available for different activities, but also assist policymakers and the public to direct funds to effective programs in high-priority areas—even when unanticipated revenue shortfalls occur.

Soaring entitlement costs, rising school enrollments, tax and expenditure limitations, and reductions in federal and state aid make budgeting wisely an even more critical task for education, health, and human services. Proposing possible responses to these pressures, Chapter 3: *Budgeting Better* outlines different ways that advocates for children and families can work to:

- *Strengthen traditional budgeting mechanisms.* Many budgeting mechanisms have become popular among state and local policymakers and other proponents for children and families. Finance reform advocates can seek to increase involvement in the budget process, reevaluate earmarked funds, or create "children's budgets." They can also reexamine the methods for reporting and tracking tax incentives in order to raise public awareness of their full costs. Developing budget contingency procedures and "rainy-day funds" also ensures that funds are well-directed. Often, these policies or procedures can help to improve the budgeting process; however, many also possess downsides or limitations.

- *Focus budgeting on performance.* Budget decisions too often neglect performance. In order to address this deficiency, states and communities can seek to create budgets that link expenditures to the achievement of important results for children and their families. Some states and communities are budgeting for results, while others are creating budgets that focus on broad cross-department and -agency functions. Assisting reformers are new tools and technologies that are making it simpler to process and carry out complex decisionmaking calculations.

▼ Developing Partnerships

Across the nation, governors, legislators, school board members, and other state and local policymakers are exploring ways to strengthen partnerships among federal, state, and local governments, as well as private organizations. They are working to combine the relative strengths of these different organizations—for example, in raising revenues or delivering services—in order to improve the delivery of social services. Chapter 4: *Developing Partnerships* provides some options, summarizing the pros and cons of different approaches to:

- *Realign governance, financing, and service delivery.* The distribution of these functions among state and local governments and the private sector has important implications for the effectiveness of education, health, and human services. State and local leaders who seek to realign these functions can consider various options, such as sharing tax revenues, creating special-purpose taxing districts, and reconfiguring government boundaries. Other options include: reassessing intergovernmental mandates, devolving or centralizing program responsibility, and building public-private collaborations.
- *Improve intergovernmental grants.* Grants for education, welfare, health, and other supports and services form an important part of existing intergovernmental structures in almost every state. When constructing grants to fund these services, grantmakers can choose from among several types of grant arrangements. Options range from using general non-targeted grants more effectively, to creating and implementing block grants, to redesigning categorical, targeted grants.
- *Restructure grant allocation mechanisms.* State and local efforts to provide funds to teachers, social service workers, and other service providers require grantmakers to address a number of important issues. These issues have important implications for which organizations or individuals receive funds, the conditions for grant distribution, and the amounts disbursed. The choices to be made include: whether to require matching funds; whether to allocate funds competitively, or on a formula basis; how to calculate appropriate resource levels; and whether to cap funding levels.

▼ Aligning Incentives

Various program, financial, and other incentives are embedded in the finance systems for education and other children's services. These incentives affect how government units, service providers, and recipients use program funds, and, ultimately, what results are achieved for children and their families. In order to ensure that incentives are aligned to encourage the provision of effective, efficient, and equitable services, state and local leaders should consider implementing two broad strategies, each of which is discussed in Chapter 5: *Aligning Incentives.*

Using incentives to emphasize performance makes up one area of options for consideration by state and local leaders. These initiatives shift incentives—both monetary and other incentives—to encourage higher performance. Options in this area include: linking pay to performance, establishing contracts for performance, and restructuring non-monetary incentives—for example, exchanging increased decision-making authority for improved performance. Modifying existing governance frameworks in order to increase positive incentives is also an option.

Another approach is to *give families with children more control over financing* by putting resources into the hands of those seeking services, instead of changing the incentives for service providers and public agencies. Sometimes termed "demand-side" approaches, these options include the often controversial charter schools, school-choice initiatives, individual development accounts, and tax incentives.

ENACTING FINANCE REFORM: STRATEGIES FOR BUILDING SUPPORT

A key ingredient in any successful effort to improve finance systems for education and other children's services is a well-developed strategy for building and sustaining public and political support for reform. Chapter 6: *Building Support for Finance Reform* presents strategies for developing the necessary commitment to improve finance systems.

Reform efforts that garner both political and public endorsements—although more challenging to pursue than those that concentrate solely on securing support from one group or the other—ensure a broad base of support for any change. They can also draw media and other attention to the need for reform. And they can help to develop improvement plans that reflect the community's needs and priorities.

To build support for change, those seeking to improve finance systems should pursue interrelated strategies and approaches. These include:

- *Laying the groundwork for reform.* Proponents of change need to clarify the purpose of reform; understand the political, economic, and other environmental factors likely to influence the success of an initiative; and build a team of policymakers who can help to initiate changes.
- *Securing political support.* Political leaders have the ability to enact reforms and draw attention to important issues. Thus, tactics to secure political champions and maintain political will are vital.
- *Increasing public knowledge and understanding of the issues.* Identifying and communicating with key stakeholders can increase public knowledge and understanding. Using the mass media and new electronic information technologies such as the World Wide Web can also help to communicate the need for reform to a broad audience.
- *Involving the public in deliberations.* Engaging the public in dialogue can clarify the issues and help in selecting the best solutions to meet the community's needs and preferences. This process can have enormous paybacks by deepening

[redacted]

support for finance system changes. To ensure that deliberations are productive, state and local leaders need to frame the issues effectively and create opportunities for productive discussions.

- *Crystallizing commitment to change.* Once a direction for reform has been chosen, policymakers and advocates for change need to make sure that a reform effort maintains adequate momentum in order to bring about change. Various approaches can be pursued to accomplish this goal, including celebrating results, publicizing the emerging consensus, and involving individuals in enacting change.

These broad strategies—when considered in tandem with the guiding principles and the policy options and choices presented in the other chapters of *Money Matters*—can help state and local leaders to take the critical steps to improve finance systems for education, health, and other children's services.

[redacted]

MONEY MATTERS: A QUICK OVERVIEW

Chapter...	Explores...	And Takes A Closer Look At Ways to...
1	**Background and Guiding Principles**	● Structure finance reform, identifying a set of principles that should guide all reform efforts. ● Translate principles into action.
2	**Generating Revenue**	● Broaden existing tax bases. ● Align revenue systems with new economic and demographic realities. ● Diversify and balance revenue systems. ● Better target tax relief.
3	**Budgeting Better**	● Strengthen traditional budgeting processes. ● Focus budgeting on results.
4	**Developing Partnerships**	● Realign governance, financing, and delivery of services. ● Restructure intergovernmental grants-in-aid. ● Reform grant allocation mechanisms.
5	**Aligning Incentives**	● Use incentives to emphasize performance. ● Give families more control over financing.
6	**Building Support for Finance Reform**	● Lay the groundwork for finance reform. ● Garner political support. ● Increase public knowledge and understanding of the issues. ● Create opportunities for public deliberation. ● Crystallize commitment to change.

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BACKGROUND: FINANCE SYSTEMS UNDER PRESSURE **1**

This section highlights the importance of education and other children's services and the critical role played by states and communities in providing and financing these services. It also explains how this guide can help states and communities improve these systems.

CONDITIONS COMPELLING STATE AND LOCAL REFORM **2**

This section describes the economic, political, and other contextual changes that are driving states and communities to seek new ideas and information on methods for improving finance systems.

GUIDING PRINCIPLES FOR REFORM **5**

This section discusses the set of interrelated principles that should guide any reform effort to improve finance systems for education and other children's services.

- ▼ **Principle 1:** Finance Systems Should Keep Pace with Change 5
- ▼ **Principle 2:** Finance Systems Should Be Robust 6
- ▼ **Principle 3:** Finance Systems Should Enhance Coordination of Services 7
- ▼ **Principle 4:** Finance Systems Should Be Equitable 7
- ▼ **Principle 5:** Finance Systems Should Be Geared to Achieve Results 7
- ▼ **Principle 6:** Finance Systems Should Reflect an Appropriate Balance of Government and Private Roles 8
- ▼ **Principle 7:** Finance Systems Should Be Responsive to the Public 8

FOUR BROAD AREAS FOR REFORM **5**

Each of the four broad areas of finance reform and their significance in shaping supports and services for children and their families are highlighted in this section.

- ▼ **Area 1:** Revenue Generation 9
- ▼ **Area 2:** Budgeting Policies and Processes 10
- ▼ **Area 3:** Partnerships, Roles, and Responsibilities 11
- ▼ **Area 4:** Financial, Program, and Other Incentives 12

TRANSLATING THE PRINCIPLES INTO ACTION: BUILDING PUBLIC AND POLITICAL SUPPORT **12**

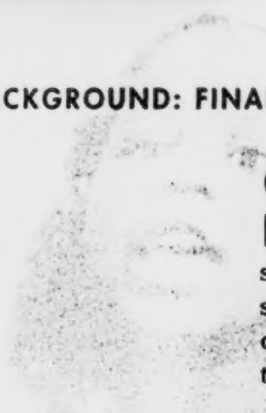
This section touches on the key steps needed to operationalize strategies for reform.

- ▼ **Step 1:** Evaluate Whether Options Accord with Principles 13
- ▼ **Step 2:** Consider Potential Barriers or Constraints 13
- ▼ **Step 3:** Investigate Other Organizational and Technical Resources 13
- ▼ **Step 4:** Build Political Support and Engage the Public 14

SUMMARY **14**

CHAPTER 1: BACKGROUND AND GUIDING PRINCIPLES

BACKGROUND: FINANCE SYSTEMS UNDER PRESSURE



Strong public support exists for strengthening our nation's schools and ensuring that children receive the basic supports and services needed to learn, grow, and develop. Yet demands to cut taxes and reduce the federal deficit require that state and local policymakers undertake these challenges under very tight fiscal pressures. Adding to these pressures are block grants and other recent federal legislative changes, which are requiring state and local leaders to quickly and radically restructure programs for children and families.

In response, policymakers in state capitols and city halls are initiating major changes in the way they conduct the public's business. They are restructuring finance and service delivery systems both in substantive fields such as human services, health, welfare, and employment and training, and in the core processes of governing. And they are striving to achieve quality results at lower costs. They also are undertaking these changes in a rapidly changing policy environment, learning as they go. To help implement these initiatives, they want information on what works, on where new initiatives are being explored, and on how to adapt promising strategies to their state or community.

Their success in this endeavor is critical to strengthening the education, health, and human service delivery systems that serve children and families. Although families have prime responsibility for raising their children, they need help from time to time in nurturing, caring for, and instructing their children.

Public schools educate many children, providing young children with basic skills and imparting valuable skills and knowledge to adolescents and young adults preparing to enter colleges, universities, and the working world. Public parks, libraries, and special events provide gathering places and opportunities for children and families to play and grow. Government programs and guidelines for ensuring clean air, pure water, police protection, safe streets, garbage collection, and many other functions also assist families in raising children.

When there are crises and families are unwilling or unable to provide adequate support to care for their children, state and local governments provide additional assistance. Low-income families, for example, may receive direct financial assistance, food stamps, medical care, and other support. Public dollars also promote children's health and development, encourage school success, protect young people from abuse, assist with child care expenses, and in many other ways help meet the health and welfare needs of children and their families.

OVERVIEW

Chapter 1, *Background and Guiding Principles*, lays the cornerstone for *Money Matters*. The chapter begins by reviewing the key economic, demographic, political, and other contextual forces compelling state and local leaders to search for new ways of financing education and other children's services. The chapter then highlights a set of principles that should guide finance reform efforts. It discusses four broad areas where state and community leaders should consider reforms: revenue generation; budgeting; partnerships among levels of government, and partnerships between the public and private sectors; and financial incentives. The chapter concludes by outlining a set of steps to translate these principles into action: evaluating the options against the principles, considering barriers, investigating resources, and building both public and political support.

In short, today's investments in children will determine how competent and caring the adults of tomorrow will be—as parents, neighbors, and workers, and as global citizens, leaders, and competitors in a world economy.

Critical to the success of these investments is the performance of state and local governments. State and local governments play an extremely large role in funding and administering education and social services. Education, the single largest public investment in children, is provided by, and almost entirely financed by, state and local governments. These two levels of government raise approximately 93 percent of the revenues for education, which totaled over $252 billion in 1995-96.[1] While the federal government and state and local governments share the responsibility for health and human services more equally, state and local governments, as well as community-based organizations, still play a very significant role in designing, financing, and administering these services.

The finance systems that support these state and local efforts play an equally critical role in determining the effectiveness of these investments. How revenues are generated, how spending priorities are determined through the budget process, how partnerships are structured between and among governments and between the public and private sectors, and how program and financial incentives are aligned, all influence how well education, health, and human service programs serve families with children.

To assist legislators, administrators, advocates, and other state and local leaders in improving these state and local finance systems, *Money Matters* provides an easily understandable guide for finance reform. It presents options, rather than prescriptions, for financing education and other children's services. It includes examples of state and local experiences and lists of resources for further information, as well as descriptive information, to assist readers in assimilating and using the information.

The different sections of Chapter 1 lay the foundation for the guide. The first section discusses the pressures on states and communities to re-examine their financing systems. It provides readers with a better understanding of the trends and issues compelling change. Next, a set of guiding principles is laid out that should guide any reform effort. The following section highlights the critical areas that state and local leaders can examine when considering ways to reform their finance systems. Finally, the chapter concludes by outlining key steps to build public and political support.

CONDITIONS COMPELLING STATE AND LOCAL REFORM

In recent years, financing and delivering education, health, and human services to children and their families has become more and more difficult for state and local governments. Although the reasons for these changes are varied, they are prompting common reactions and responses.

Key Factors Forcing Change

Some of the reasons for the mounting pressure reflect larger changes in the American landscape. These include increases in student populations and the needs of children and families; a changing economic context; reduced federal support despite persistent federal requirements; and public demands for a smaller government sector. Others are the result of past patterns of spending.

Today's investments in children will determine how competent and caring the adults of tomorrow will be—as parents, neighbors, and workers, and as global citizens, leaders, and competitors in a world economy.

Growing Demands for Education and Other Children's Services Exert Increasing Pressure

Changes in the American population are having important implications for children, youth, and their families (throughout the rest of the document, we use the term "children" as comprising all children and youth between the ages of 0 and 18). One of the most important changes is the number of children enrolled in public schools, which has climbed steadily since the mid-1980s after many years of declining enrollments. This trend, coupled with the fact that growth in the school-age population will continue to outpace growth in the general population, may make it increasingly difficult for states and communities to increase or even maintain real per-pupil spending levels.

In addition, changes in the needs of children and families are also exerting pressure to provide additional help to children and families. Child poverty, which is an indicator of the need for a range of public health and social welfare services for children and families, has been increasing in recent years. In fact, both the child poverty rate and the number of children in poverty have been on the rise since 1970, despite the fact that in past years these figures have tended to fluctuate with business cycles. The presence and severity of other inhospitable family and community conditions—such as neighborhood violence, unstable employment, and dysfunctional family life—also indicate the continuing needs for social services provided to children and families.

Evolving Economic Conditions Require States and Communities to Adapt

Changes in the economy are also requiring states to adapt their finance systems to better serve the needs of children and families. Slower economic growth makes it difficult for state and local governments to support education and other services for children and families. Relatively low growth rates make raising public revenues at all levels of government, including state and local levels, a more contentious issue.

Compounding the effects of the slowdown in overall economic growth is the failure of many states and local governments to adjust to economic and demographic shifts in the nation's economy. Two of the most important trends that are having a large impact on states and communities are the shift in our nation's economic base towards services, and the change in sources of individual family incomes. These shifts have forced many businesses and individuals to bear more than their fair share of the burden for financing public services, while others assume less than their fair share.

State and Local Governments Must Cope with Federal Changes

Changes at the federal level are also prompting state and local governments to focus on improving their finance systems. Declining federal aid has increased state and local governments' fiscal responsibilities for many public programs and services. While Medicaid continues to grow rapidly, states and localities must finance a host of other programs that support children and families—such as training, employment, social services, community affairs, and regional development—and with much less federal support.

Additional federal cuts in real levels of aid to state and local governments are extremely likely, and will have important ramifications for funding services to children. The new welfare program, Temporary Assistance for Needy Families, for example, reduces the amounts that would have been spent for food stamps and benefits to noncitizen legal immigrants over the next six years. And the hue and cry for a balanced federal budget points to further reductions in federal spending for discretionary grants to states and localities.

Federal mandates over the last three decades have also added to state and local governments' financing responsibilities, while at the same time reducing flexibility in how states and localities use their funds. Although some actions have been taken to alleviate this pressure, these mandates have claimed valuable resources and have begun to prompt states and communities to think about methods for reallocating their investments to better use their funds within these constraints.

The Public Demands Leaner, More Efficient Government

An increasingly demanding public is also placing pressure on states and communities to improve services for children and families while holding the line on—if not reducing—taxes. The public is acutely aware of the conditions endangering children and families. Low educational achievement, increasing drug and alcohol use among children and teenagers, unwanted teen pregnancies—these are just a few of the problems that citizens and taxpayers want the government to address. The public is also pressing state and local governments to use new information and communication technologies to make government more efficient, accessible, and responsive to the needs of children and families. Demands to upgrade public record-keeping, data collection, and information processing systems to employ modern technology are increasing, as are demands to educate and train our children to use these tools.

But—as calls for balanced budgets, tax cuts, and tax limitations attest—states and communities must balance these pressures to improve services against the strong public sentiment to reduce government spending. In short, the public is demanding that state and local governments continue to serve children and their families, but do so in a leaner, more efficient manner.

Past Spending Patterns Add Pressure to Refocus on Results

Previous patterns of spending, particularly those that primarily respond to the needs of children and families once they have reached crisis levels, also have added pressure on states and communities. These patterns address problems that could have been avoided if proper preventative action had been taken. They reflect a failure to invest in the health, education, and family support services that yield large dividends by preventing the costs of bad outcomes.

Many experts believe that the failure to pay for these up-front costs has elevated the need for costly family interventions, substance abuse treatment programs, juvenile detention programs, and other supports and services for children and youth with critical needs. The costs of these traditional programs compound fiscal pressures on states and communities trying to address the needs of children and families.

It is increasingly apparent that without finance system changes, it will be difficult to improve the quality of education, health, and other services for children.

States and Communities Focus on Finance Reform

Given these mounting pressures, it is increasingly apparent that without finance system changes, it will be difficult to improve the quality of education, health, and other services for children. In response, state and local leaders across the country are seeking new ways of financing and delivering public services for children and families. They are also searching for new strategies and methods to improve the efficiency, effectiveness, and equity of these systems.

This guide offers ideas and options for finance reforms that can result in sustained improvements in the quality of services provided to children, and the results that are achieved through those services. Some of the initiatives discussed represent incremental steps to modify existing systems, such as adjusting tax rates or changing eligibility standards. Others attempt more far-reaching reforms, such as restructuring revenue systems; building more comprehensive service delivery systems for children and families; and tying budget and management systems to the achievement of desired results. All represent strategies to improve the finance systems for education, health, and human services.

The remainder of this chapter lays out principles that should guide any reform effort, the four aspects of finance that should be considered as areas for change, and the actions that are needed to translate the principles and options into action.

GUIDING PRINCIPLES FOR REFORM

Citizens and their governments can improve the return on public investments in children and the quality of programs serving them by reforming finance systems. But what principles should guide their movement toward these goals? While no finance system can achieve every desired objective, the innovations and options presented in this guide are predicated on the following principles that, in combination, can help state and local governments build more efficient, effective, and equitable systems of finance.

▼ Principle 1: Finance Systems Should Keep Pace with Change

Our world is constantly changing—every year young children across the nation enter school for the first time, while young adults prepare to leave school and make their start in the working world. New technologies emerge and evolve that make it quicker,

GUIDING PRINCIPLES AT A GLANCE

Finance systems should...

- **Keep pace with change**, adapting to current economic, demographic, and technological realities.
- **Be robust**, to ensure a stable and supportive foundation for children and families, even in adverse circumstances.
- **Enhance coordination of services** to be sure that resources are used efficiently and meet the interrelated needs of children and families.
- **Be equitable**, promoting fair opportunities for children to learn and grow, and distributing tax burdens in a reasonable and fair manner.
- **Be geared to achieve results**, to make sure that funds for children and their families are well spent.
- **Reflect an appropriate balance of government and private roles**, recognizing the relative strengths of each in financing services for children and their families.
- **Be responsive to the public**, reflecting their needs and priorities, and engaging parents, taxpayers, and others in reform efforts.

simpler, and less expensive to analyze complex problems, to communicate with others, and to access valuable information. New service-oriented businesses are started and expanded while manufacturing-based businesses reduce the size of their operations. Individual spending patterns and priorities shift, reflecting changes in our tastes and lifestyles. New legislation redefines the way that government services are provided.

Accordingly, finance systems should keep pace with change. They should reflect modern conditions, including current economic, demographic, and technological realities. They should also take advantage of recent advances in knowledge and technology, utilizing lessons learned from experience and research, or new computer-based tools for processing information. Finance systems that adapt to current patterns and trends are critical in providing efficient supports and services for children, youth, and their families. In particular, revenue systems that reflect structural changes in the economy and population are more likely to be fair and efficient; adequate for financing education and other children's services; and more acceptable to the public. Such budgetary systems are more likely to run smoothly and efficiently, and systems for allocating grants to other levels of government or to schools or local service providers are more likely to be fair.

▼ Principle 2: Finance Systems Should Be Robust

Unexpected downturns in a state or local economy can have a significant impact on tax revenues, and, in turn, on education, health, and human services. Increased needs for education, child care, and other supports can also draw on an area's resources. Like the design of a house, the design of a finance system greatly affects its ability to weather unexpected events and adjust to and meet changing needs. A firm foundation, strong materials, and quality craftsmanship are important ingredients for designing and building a lasting product, whether it be a building or a program to serve children and families.

To provide quality services for children and families, a finance system should be robust, that is, well constructed to maintain its strength through adversity. Revenue systems that are balanced and rely on a range of diverse revenue sources—rather than one or two particular sources, for example—are best equipped to deal with economic downturns. Budget systems that incorporate mechanisms to reprioritize spending when unanticipated events occur also strengthen a finance system. Systems that align incentives to encourage performance are more likely to be healthy, and systems that have a strong foundation of political and public support require fewer modifications and alterations.

▼ Principle 3: Finance Systems Should Enhance Coordination of Services

Recent efforts to reform supports and services for children and their families have focused on creating more comprehensive, community-based support systems. These efforts seek to serve the multiple needs of children and their families by providing more prevention-oriented, flexible, and family-centered services than have traditionally existed. They attempt to reduce the number of traditional categorical funding arrangements that prohibit the various parts of the finance system from working together and thus make it difficult to adequately address the multiple needs of children and families.

The various parts of the finance system should enhance the delivery of education, health and human services. Pieces of the revenue system should fit together well.

[redacted]

Revenues need to be adequate in order to meet desired objectives. Impacts of one part of the system on another also need to be considered: intergovernmental grants should minimize unnecessary restrictions and requirements, and incentives need to be aligned with desired results.

▼ Principle 4: Finance Systems Should Be Equitable

Securing equitable, or fair, opportunities for children and their families to grow and prosper has been a compelling rationale for federal, state, and local government policy in a number of areas, including education and health policy. Parents and advocates have argued that all children—whether they be limited-English proficient, economically disadvantaged, or physically disabled—should have equal opportunities to succeed. Strong public support for these objectives has allowed these groups of children to secure various protections, including program expansions, legal access guarantees, and targeted categorical assistance.

Equity is also an objective that needs to be addressed throughout the finance system. Not only do services and opportunities need to be distributed fairly among children and families, but tax burdens should be shared equitably among taxpayers. Grants should be allocated among recipient governments in order to achieve acceptable standards of equity. Within the intergovernmental context for providing education, health, and human services, standards of equity will need to reflect community standards developed through public participation in the design of finance systems.

▼ Principle 5: Finance Systems Should Be Geared to Achieve Results

Healthy infants and children, well-educated schoolchildren, self-sufficient families, and safe and supportive schools and communities are only a few of the results that Americans frequently seek for their children, families and communities. In city council hearings, school board meetings, and state legislatures across the nation, citizens and public leaders reinforce the importance of achieving these positive results. Public opinion polls emphasize the desirability and critical importance that citizens from all walks of life place on obtaining positive outcomes for children, families, and communities.

Finance systems must be aligned with the results desired by a state or community to ensure that children grow into healthy, productive citizens and leaders in our world economy. To accomplish this, government decisionmaking and administrative processes should be structured to promote positive results for children and their families, including well-educated and healthy children, self-sufficient families, and safe communities. Communities also need to engage political leaders and the public in clarifying priorities, forming decisions, and narrowing options.

It is equally important to combine budgeting with results. The budget process should link critical policy choices about how to invest public funds with information about the performance of various programs, including prevention-oriented programs that may prevent costly expenditures in the future. And financial and other incentives for service providers, program administrators, and the children and families they serve, must be aligned with the public's goals.

▼ Principle 6: Finance Systems Should Reflect an Appropriate Balance of Government and Private Roles

Public schools, private child care centers, non-profit and community-based youth centers, community health centers, school-based health clinics, and strong local police forces all play significant roles in educating, supporting, and caring for our children. This rich mix of resources supporting children and their families reflects the fact that children and families have multiple needs, some that are addressed by the public sector, but others that are best met by teachers, doctors, counselors, and coaches from the private or non-profit sectors. There is no set recipe for success when raising or nurturing a child; the appropriate supporting mix of public and private services is determined by each family, and often reflects the types of resources available to the family within the community.

To best serve children and their families, finance systems should reflect an appropriate balance between public and private roles. Often, efficiency can be improved when the advantages of private market operations and mechanisms are incorporated in the design of public finance systems. In designing tax systems, adherence to this principle means creating a system that minimizes interference with the economic decisions of businesses and individuals.

When assigning roles and responsibilities for raising revenues or administering a program, states and communities should establish public-private partnerships where such synergy can best serve the needs of children and their families. In some cases, public operations should also draw on the mechanisms and conditions that enhance efficiency in the private sector: demand-driven allocation of resources, and rational decisions made with good information.

KEEP IN MIND...

These principles provide a sound and consistent framework and promising directions for practical reform.

Legal, economic, demographic, and political constraints may need to be addressed in order to pursue actions most consistent with sound principles for financing reform.

Some options may be best suited to promoting particular principles, requiring communities to evaluate options against their priorities.

▼ Principle 7: Finance Systems Should Be Responsive to the Public

Public supports and services for children and families are funded through a variety of sources, including individual income taxes, taxes on the sale of goods and services, property taxes, and user fees and charges. The individuals, families, and businesses who pay for these services want the public sector and its leaders to ensure that their hard-earned money is being well spent. They are demanding that government be increasingly accountable for the money they spend.

Decisions about the financing of education and other services for children must be shaped by the priorities of the public and their political leaders. Since these priorities may shift as new problems emerge and old crises are resolved, it is important that finance systems for education and other children's services be responsive as well. Ensuring lasting support for finance reform requires engaging political leaders and the public in a process of education, deliberation, and decisionmaking. Again, this principle has important implications for how best to design a finance system for education and other children's services. For example, intergovernmental systems of finance should balance the policy priorities of higher levels of government with the ability of lower levels of government to respond to local conditions.

FOUR BROAD AREAS FOR REFORM

Finance systems play a critical role in education, health, and human service systems. Four key structural elements of the public financing of education and other children's services affect the level and nature of the services that are provided. They are:

- Generating revenues;
- Budgeting;
- Developing partnerships between governments and between the public and private sectors; and
- Aligning incentives.

These broad areas provide opportunities for those wishing to alter the quality and scope of programs and services for children, youth, and their families. Each of these areas and their significance in shaping education and other children's services are described briefly below. Specific options for reforming these areas are presented in Chapters 2 to 5.

▼ Area 1: Revenue Generation

When many people think of finance, they think of how to raise money or generate revenue for a particular activity or function. Revenue generation is a critical component of the system for financing education and other children's services, although certainly not the only component. All other things being equal, the larger the size of the revenue pie, the easier it is for a state or local government to fund supports and services to meet the needs of children and families.

The design of the revenue generation system significantly affects the overall *amount of resources potentially available* for public purposes, including education and other children's services. The relative reliance on different tax and revenue sources such as the property, income, or sales tax, can have a large impact. Similarly, whether individuals or businesses are treated in a uniform manner can affect the amount of revenues raised to fund supports and services for children, youth, and their families.

In addition, the design of the revenue system is an important determinant of the *stability and growth of revenues*, both of which can significantly affect the quality of services provided over time. Revenue stability and growth are essential if per-pupil spending on education and spending levels for other children's programs are to be maintained or improved over time. Very unstable revenue streams—for example, from revenue structures that are highly dependent on taxes subject to cyclical swings—can negatively affect the continuity of program funding levels and, ultimately, service levels.

Revenue systems that fail to yield revenues that grow in line with public service needs will cause continuing fiscal crises by forcing jurisdictions to continually rebalance their revenues and expenditures. On the other hand, a revenue system that addresses any potential mismatch between revenues and expenditures *provides more predictability* for service recipients. It allows taxpayers, program administrators, and others to plan more effectively for the future—for example, estimating the levels of child care slots or other services that will be provided.

Public perception of the ways that a government raises revenue is a critical factor in the *political support for the overall system*, and thus for the adequacy, stability, and growth of revenues that support services for children and others. For example, how fair the distribution of taxes paid by different individuals and businesses is perceived to be can significantly affect public support. Similarly, how taxes affect individual businesses and the overall business climate can have an indirect but extremely important effect on how much support exists for education and other social services.

REVENUE SYSTEM DESIGN AFFECTS...

Amounts of Revenue Available for Children's and Other Public Services

Stability, Predictability, and Growth of Revenues

Acceptability of the Overall System to the Public

▼ Area 2: Budgeting Policies and Processes

Budgeting also plays a critical role in the finance system, *determining relative spending priorities* among education, health, human services, and other government functions. These priorities are reexamined on a periodic basis, often yearly, and restructured as local needs and community priorities shift. The budget process represents an important opportunity for those concerned with education and other children's services to ensure that they get their fair share of the "revenue pie."

Revenues for education and other children's services can be budgeted in a variety of ways. For example, monies can be allocated through budgeting processes in which funding for children's and family services competes with funding for other programs. Alternatively, states or local governments can use mechanisms that tie all or a portion of specific revenue streams to particular programs.

The choice of budgeting mechanisms has a direct effect on the *adequacy of funding* for education and other child and family services relative to the need for those services. For example, a child care program whose funding depends solely on an earmarked revenue source, such as the retail sales tax, that was sensitive to economic cycles would do a poor job of providing a stable level of resources for this critical need.

Public perception of the budgeting system *can enhance or undermine the public support* for the financing of education and other children's services. An entitlement approach to funding education or other children's services, for example, may ensure that all those eligible for the program are served regardless of funding source or the child's or family's economic circumstances. But such an approach can also build public resentment if taxpayers fail to see the rationale for assistance or if the growth of such programs comes at the expense of other programs.

BUDGETING POLICIES AND PROCESSES CONTROL THE...

Scope and Type of Programs that Receive Funding

Amounts of Resources Available Relative to Needs

Purposes for which Funds are Expended

In addition, the basis on which budget decisions regarding children's and family services are made determines the *level and nature of programs that are funded and the goals that these programs are intended to achieve.* Ideally, investments in education and other children's programs are intended to achieve specific results. Traditional budgeting processes, however, often fail to incorporate sufficient information about the performance of programs in allocating funds to education and other children's programs. Occasionally, decisions on spending priorities are made on an even less rational basis, relying on strategies such as granting across-the-board increases to existing programs. To the extent that these budget processes are missing links to program performance, their likely effectiveness and efficiency in meeting intended goals are seriously compromised.

▼ Area 3: Partnerships, Roles, and Responsibilities

The roles and responsibilities for various levels of government and the private sector in financing education and other children's services are another critical financing area that those interested in improving these supports and services should consider. The number, level, and type of governmental units and other organizations responsible for raising revenue, administering programs, or providing services can have an important impact on how education and other children's services are delivered. Similarly, the mandates imposed and the design of grants used to distribute funds from higher levels of government to lower levels can have important effects.

The distribution of responsibilities among governments, governmental units, and the non-profit and private sectors can have a profound effect on the *variations in the level of spending* for different supports and services across communities within a state. The nature of the partnerships between state and local governments—for example, in funding public education—can affect spending levels as well as curriculum choices and other features of school programs. Similarly, how funds are distributed from a higher level of government to lower levels—that is, the design of grants and formulas—can also have significant impacts on the levels of services reaching the ultimate recipients.

In addition, how partnerships are structured affects the *flexibility and cooperation* that each government or governmental unit has in the use of its funds as a result of requirements or restrictions placed on it by others. The fragmented system of services for children and families that exists today, for example, has resulted, at least in part, from highly categorical requirements placed by grantmakers on the use of grant funds. Similarly, intergovernmental mandates to provide certain types or levels of children's services—such as a minimum number of school days or health screening and treatment for certain children covered by Medicaid—affect the flexibility that communities have in determining their priorities.

ASSIGNMENT OF ROLES AND RESPONSIBILITIES AMONG DIFFERENT LEVELS OF GOVERNMENT AND BETWEEN THE PUBLIC AND PRIVATE SECTOR AFFECTS...

Uniformity or Variation in Service Levels

Local Spending Priorities, Program Design, and Flexibility

Revenue Distribution Among Jurisdictions

Governmental arrangements for collecting and distributing revenue also have an impact on the *level of tax resources available in a jurisdiction.* The appropriate matching of responsibilities, resources, and authority among levels of government thus requires the attention of policymakers if quality services are to be provided that meet the needs of children and families.

▼ Area 4: Financial, Program, and Other Incentives

Embedded in finance systems for education and other children's services are various incentives that affect *how governmental units, service providers,* and *recipients use program funds.* As one example, the basis on which teachers, case workers, and other service providers are rewarded can provide a powerful incentive for determining how the funds are used. That is, a provider, such as the head of a protective service agency, might make less efficient use of administrative funds, knowing that the agency's total budget will be cut if it finds ways to reduce administrative costs in order to redirect funds to assist clients.

Similarly, the degree to which the finance system allows families or individuals to decide directly how and where to use public funds affects the ultimate pattern of resource allocation of these funds. Providing families with school vouchers, for example, may well result in different patterns of school enrollment than if students in those families are simply assigned to schools.

FINANCIAL, PROGRAM, AND OTHER INCENTIVES AFFECT...

Use of Public Funds by Governments, Service Providers, and Recipients

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Pattern of Resource Allocation

Results Achieved for Children and their Families

The incentives for using education, health, and human service funds also play a significant and direct role in determining *the results of those investments.* Management systems and financial incentives that focus only on resources or inputs—for example, teacher compensation that is determined solely by credentials and years of service—are unlikely to support quality services.

If incentives are more explicitly aligned with desired results, they increase the likelihood that programs will achieve those results in the most efficient manner. This alignment can be achieved in a number of ways: by forcing a clearer public debate about goals that programs should strive to achieve; maintain the focus of service providers and the public on the goals against which program performance should be measured; and clarifying who is responsible for achieving those goals.

TRANSLATING THE PRINCIPLES INTO ACTION: BUILDING PUBLIC AND POLITICAL SUPPORT

When launching a new finance initiative to improve education or other children's services, several key steps are needed to translate these principles into action. This section briefly outlines some of these steps. Chapter 6 discusses the strategies and actions needed to build public and private support in more detail.

▼ Step 1: Evaluate Whether Options Accord with Principles

One of the most important steps in improving the system for financing education and other children's services is evaluating the different options in light of the guiding principles for reform. Those involved in weighing the different options—whether they be school board members, community leaders, or state officials—should ask the following types of questions to determine the potential effectiveness of a particular reform strategy: Does the option align with all of the guiding principles? Is it in direct contradiction with any of the principles set forth? Are some principles more important to the community than others? Which options correspond most closely to the state's or community's priorities?

Evaluating the congruence between the options being considered and the set of guiding principles can help leaders at the state or local level to prioritize, rank, and select options that are consistent with their needs and priorities. While the options described in this guide are predicated on the guiding principles, some options are often better at accomplishing a particular objective than others. For example, expanding the sales tax base to include services is a particularly effective option for aligning the revenue system more closely with modern realities and spreading the burden of financing services more equitably among taxpayers.

▼ Step 2: Consider Potential Barriers or Constraints

An equally important step in translating the principles into action is determining whether any barriers exist that might prevent a state or community from implementing options consistent with these principles. Often legal, technical, or organizational constraints exist that may make it difficult to implement a particular reform option.

These arrangements, however, should not necessarily limit the range and types of options considered. Rather, they should be taken into account in evaluating the most effective method for financing education and other children's services. In fact, it may be relatively simple to modify existing arrangements.

▼ Step 3: Investigate Other Organizational and Technical Resources

A third critical step for those choosing among and implementing the various options is gathering additional information about the different reforms. This information should extend the information available in *Money Matters*—which is primarily intended to serve as a starting point to considering a variety of options for improving finance systems for education and other children's services.

More in-depth information on the potential costs and benefits of each option is available from the organizations listed in each chapter's resource section. Similarly, information on a particular state, county, or community organization's experience in implementing a reform can provide additional insight into which option is best suited to local needs and conditions.

▼ Step 4: Build Political Support and Engage the Public

Finally, building support for change is a critical step for effecting meaningful reforms. The most effective campaigns to develop interest and support for financing reforms build support among two key groups: political leaders and the public.

High-profile political or business leaders—for example, governors, state legislators, school superintendents, county officials, or local business executives—can use their resources and their positions to bring about needed change. They can also use their position to bring attention to the issue and ***develop consensus for change*** in the way states and communities finance education and other children's services. Similarly, building broad-based public support can have very significant payoffs through mobilizing community resources and ensuring that the option being pursued meets the needs of children and their families.

POLITICAL SUPPORT AND PUBLIC ENGAGEMENT AFFECT...

Consensus for Financing Changes

Sustainability of Reform Efforts

Appropriateness of the Selected Option to the Community's Needs

Political support and public support are critical factors to ***ensuring sustainability*** of any finance reform for education and other children's services. Although children and families may be better off, some groups may benefit from the change, while others may be made worse off by it. However, to ensure that vocal opponents do not derail efforts to improve or reverse fledgling reforms, it is critical to build a broad base of support for change, taking into account how the change may adversely affect particular groups.

Engaging the public is particularly critical for ***tailoring the financing option*** to a community's needs. Not all options work well in all areas. Varied economic and demographic conditions, as well as differences in state and community priorities, shape which options are most viable in a particular area. Involving the public and its leaders in determining which option fits best will increase the likelihood of success for the chosen option.

SUMMARY

Critical trends and issues are forcing states and communities to reconsider the ways they finance education and other children's services. Changes in the needs of children and their families, a shifting economic situation, past spending patterns, and a new intergovernmental policy context are all prompting those concerned with children and their families—whether they are in the public sector or simply concerned with improving supports and services for families—to seek new ways of financing supports and services for children, youth, and their families.

In order to assist state and local policymakers and those wishing to influence policy, this guide lays out a series of options for improving financing systems. These options are predicated on a set of seven principles that should guide reforms. Financing systems should (1) keep pace with change, (2) be robust, (3) be coordinated, (4) be equitable, (5) be geared to results, (6) reflect an appropriate balance of government and private roles, and (7) be responsive to the public.

When considering reform, state and local leaders should consider four broad areas that provide opportunities for improving financing systems: (1) revenue generation, (2) budgeting, (3) partnerships between governments and the public and private sector, and (4) incentive alignment. These four areas affect critical aspects of education and other children's services, including the amounts of revenue available; the scope and types of programs funded; the stability, predictability, and political acceptability of the provision of these services; and the uniformity and variation in service levels.

Translating the principles into action requires a number of important steps, including evaluating options, considering barriers, investigating other resources, and building strong political and public support. Strong support for improvements, in turn, is critical to developing consensus for finance changes, maintaining the sustainability of reform efforts, and tailoring the option to the community's needs.

NOTES

1 National Education Association, *1995-1996 Estimates of School Statistics*, p. 41.

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CHAPTER 2: GENERATING REVENUE

BACKGROUND: RAISING NECESSARY RESOURCES

When it comes to financing services for children, raising the dollars matters as much as knowing how to invest them wisely. Governments need to raise enough money to pay for the services that citizens want and need, and they need to raise it in ways that are fair, efficient, and responsive to the public. Revenue systems that are unproductive, unfair, unresponsive, or poorly managed harm families, businesses, and the public's confidence in government. Thus, if children's services are to be adequately supported and financed, the systems that generate government revenue also need to be well structured.

Yet many state and local government revenue systems are ill prepared for their important task. A number of significant trends make it particularly important now and for the future that systems for generating public revenue for children's services be improved:

- *Programs for children and families dominate state and local government spending.* K-12 education alone—the single largest component of state and local budgets—consumes almost a quarter of all general revenue raised by these governments. When other public services are considered—such as higher education, public health, social welfare, library, parks, and recreation programs—the share of government resources that benefits children and their families is even greater.[1]
- *Growth of state and local government resources is not keeping pace* with the numbers of children in this country. The ability to generate revenue has not kept pace with the demand for children's services. In the 1990s, the annual growth rate of revenue raised by states and localities, adjusted for inflation and for the number of children who may need services, is roughly half of one percent—dramatically below that of periods since 1970 (see Table 2-1).
- *Brutal competition often exists among rival government programs* for increasingly scarce public dollars. Children's programs must vie, often fiercely, with other public programs such as corrections, garbage collection, environmental protection, medical assistance, transportation, and public works.
- *Economic, social, and political environments have changed* more rapidly than have state and local government revenue systems. For example, existing revenue systems are designed to tax a predominantly goods-based, manufacturing economy, while, today and in the foreseeable future, relatively more economic activity is coming from services. Interstate and international commerce and competition have also grown rapidly, which creates new challenges for state and local taxation of businesses.

OVERVIEW

Chapter 2, *Generating Revenue*, delves into various strategies to make state and local revenue generation systems more productive, fair, and efficient when raising funds for education, health and other children's services. It begins with options to broaden existing sales, income or property tax bases. The chapter also reviews options for keeping pace with economic and demographic changes. The methods discussed include expanding taxes on interstate commerce, maintaining parity between property tax assessments and current market values, and re-examining tax incentives for businesses. Options for taxing multistate and multinational companies as well as evolving industries are also examined. The chapter then highlights options for diversifying and balancing revenue systems, for example, by reducing reliance on one tax source or generating revenues through non tax sources. The chapter concludes by suggesting methods for making more efficient use of tax relief mechanisms—preserving tax revenues by better targeting relief to those in need.

Four Directions for Reform

This chapter focuses on four broad directions that policymakers are using to upgrade revenue systems. They are identifying, testing, and putting in place strategies that:

- Broaden existing tax bases;
- Align taxes with new economic and demographic realities;
- Diversify and balance tax systems; and
- Better target tax relief.

These are four powerful directions for reform, not emergency measures. If pursued, they can result in revenue systems that are more productive, fair, and efficient—that is, that produce more revenue with less harm to citizens and their communities. Increasing the tax rate, another straightforward but politically unpopular option for generating revenue, is not discussed in this chapter. Indeed, the options discussed here can help policymakers avoid the need to raise tax rates while still producing needed levels of revenues.

The contents of this chapter merit serious consideration by government leaders and others who seek to improve the lives of children. Included are key policy principles and revenue-generating options for state and local governments to consider. They are based on theoretical and empirical research, as well as the rich experience of state and local governments in generating revenue.

However, since governments are unique—each with its own set of needs, conditions, and preferences—there are no universal remedies, recipes, or instructions to guarantee success. What works well to raise revenue in one jurisdiction may be inappropriate, undesirable, or infeasible in another.

Furthermore, more money in the pot does not guarantee more or better children's services. As resources grow, state and local governments may not automatically increase spending or improve the return on investments in education, health care, juvenile justice, and other programs that benefit children. Child advocates still must make a strong budgetary case for

TABLE 2-1

STATE AND LOCAL REVENUE GROWTH RATE

Annual Inflation-Adjusted Rate Per Person Under 18

1970 - 1975	4.7%
1975 - 1980	3.7%
1980 - 1985	6.2%
1985 - 1990	5.6%
1990 - 1993	0.6%

Source: U.S. Bureau of the Census

WHEN WE TALK ABOUT AMERICA'S CHILDREN, LET'S KEEP IN MIND...

Americans traditionally expect government to provide certain services for children.

Inadequate government revenue systems virtually guarantee starved services.

Children's issues and those of raising public revenue are very closely interrelated.

The future of children's programs, and therefore, of America's children, depends in large part on more productive, efficient, and responsive strategies for raising public revenue.

their share of any and all revenue generated. So, too, citizens and leaders in the public and private sectors must work closely together to make sure that children's programs work well.

STRATEGY 1: BROADEN EXISTING TAX BASES

Sales, property, and income taxes form the tripartite foundation for financing state and local government. Table 2-2 illustrates the relative importance of these three tax bases to state and local governments in the aggregate.

Although property, sales, and income taxes are the three major sources of tax revenue for state and local governments, states and localities rely on these sources to different extents. At the state level, general sales and individual income taxes are critical—together yielding about half of total general revenue (see State Revenue column). In localities—cities, counties, towns, school districts, and other special purpose jurisdictions—the property tax is the most substantial source of financing public services, alone yielding about half of total general revenue (see Local Revenue column).

But over the years, these taxes have become less productive. Generations of legislative sessions have created base-narrowing tax preferences and rigid tax structures

TABLE 2-2

GENERAL REVENUE RAISED BY STATE AND LOCAL GOVERNMENTS 1992-93

Revenue Source	State and Local Revenue		State Revenue		Local Revenue	
	$Million	% of Total	$Million	% of Total	$Million	% of Total
Total Taxes	592,818	70.6%	353,847	76.0%	238,970	63.8%
Property Taxes	188,535	22.5%	7,796	1.7%	180,738	48.3%
General Sales Taxes	138,776	16.5%	114,635	24.6%	24,141	6.4%
Selective Sales Taxes	70,770	8.4%	59,908	12.9%	10,862	2.9%
Individual Income Taxes	123,220	14.7%	112,114	24.1%	11,106	3.0%
Corporate Income Taxes	26,417	3.1%	24,195	5.2%	2,222	0.6%
Other Taxes	45,101	5.4%	35,200	7.6%	9,901	2.6%
Current Charges[a]	147,552	17.6%	57,384	12.3%	90,168	24.1%
Miscellaneous Revenue[b]	99,400	11.8%	54,075	11.6%	45,325	12.1%
Total General Revenue	839,769	100.0%	465,306	100.0%	374,463	100.0%

Note: Numbers may not add due to rounding.

[a] Includes fees, assessments, and other reimbursements for current services.

[b] Includes interest earnings and other revenue.

Source: U.S. Bureau of the Census

that respond inadequately to changing economic and social conditions. The result? An increasingly larger portion of total economic activity is going untaxed.

Besides creating inequities for taxpayers and inefficiencies for businesses, the gap between what is taxed and what could be taxed means less potential revenue for children's services and other public services, as well as greater competition for the revenues that are raised.

States and localities should consider broadening the three major taxes so that their tax bases come closer to matching what is considered ideal. The critical issue is not the amount of the revenues raised, but the extent of economic activity covered.

Broadening existing tax bases to capture more economic activity offers real potential for strengthening revenue systems and the financing of children's services. Options for broadening the sales, income, and property tax bases are examined below in turn.

▼ Option 1: Broaden the Sales Tax Base

State and local governments can collect more sales tax revenue without increasing the legal, or "advertised," tax rate by expanding the sales tax base to more fully encompass consumption spending. Local retail sales taxes generally, but not always, follow the base of their state. Therefore, in the discussion here, comments about state sales taxes should be understood to apply also to local taxes within the state.

States with broader sales tax bases can raise significantly larger amounts of revenue with a given tax rate. Consider that the tax bases of the ten states with the broadest taxes encompass around 68 percent of state personal income, while those of the ten states with the narrowest taxes encompass about 33 percent of state personal income—a ratio of about 2 to 1. Thus, equal statutory tax rates would produce about twice as much revenue in a state with one of the broadest tax bases as in a state with one of the narrowest tax bases!

The two major options for broadening the sales tax base include eliminating current exemptions for certain classes of goods, and taxing service purchases more aggressively. In addition, states can reduce the discounts given to vendors for collecting taxes.

▼ *Eliminate Current Exemptions for Certain Classes of Goods*

States and localities normally tax purchases of goods more broadly than purchases of services. But governments lose substantial revenue from exemption of goods. Several classes of these goods purchased by households could reasonably be taxed, and frequently are (see Table 2-3). These purchases are starting points for consideration in broadening the sales tax base.

Reduce Exemptions for Household Food Purchases

The largest revenue gain from eliminating exemptions could come from taxing household food purchases. These exemptions typically represent a loss of roughly 20 to 25 percent of the potential sales tax base.

Exempting family food purchases from retail sales taxation reduces the regressive nature of the general sales tax. However, because food exemptions apply equally to rich and poor families, they cause tax payments to vary according to the amount of

TABLE 2-3

SALES TAX TREATMENT OF SELECTED COMMON HOUSEHOLD PURCHASES, 1996

State	Food	Residential Electric	Residential Gas	Water	Intrastate Telephone
Alabama	Tax	Exempt	Exempt	Exempt	Exempt
Arizona	Exempt	Tax	Tax	Tax	Tax
Arkansas	Tax	Tax	Tax	Tax	Tax
California	Exempt	Exempt	Exempt	Exempt	Exempt
Colorado	Exempt	Exempt	Exempt	Exempt	Tax
Connecticut	Exempt	Exempt	Exempt	Exempt	Tax
Florida	Exempt	Exempt	Exempt	Exempt	Exempt
Georgia	Tax	Tax	Tax	Exempt	Tax
Hawaii	Tax	Exempt	Exempt	Exempt	Exempt
Idaho	Tax	Exempt	Exempt	Exempt	Exempt
Illinois	Lower Rate	Exempt	Exempt	Exempt	Exempt
Indiana	Exempt	Tax	Tax	Tax	Tax
Iowa	Exempt	Tax	Tax	Tax	Tax
Kansas	Tax	Exempt	Exempt	Exempt	Tax
Kentucky	Exempt	Exempt	Exempt	Exempt	Tax
Louisiana	Exempt	Lower Rate	Lower Rate	Lower Rate	Tax
Maine	Exempt	Tax	Exempt	Exempt	Tax
Maryland	Exempt	Tax	Tax	Exempt	Exempt
Massachusetts	Exempt	Exempt	Exempt	Exempt	Tax
Michigan	Exempt	Tax	Tax	Tax	Tax
Minnesota	Exempt	Tax	Tax	Exempt	Tax
Mississippi	Tax	Exempt	Exempt	Exempt	Tax
Missouri	Tax	Exempt	Exempt	Exempt	Tax
Nebraska	Exempt	Tax	Tax	Tax	Tax
Nevada	Exempt	Exempt	Exempt	Exempt	Exempt
New Jersey	Exempt	Exempt	Exempt	Exempt	Tax
New Mexico	Tax	Tax	Tax	Tax	Tax
New York	Exempt	Exempt	Exempt	Exempt	Tax
North Carolina	Tax	Tax	Tax	Exempt	Tax
North Dakota	Exempt	Exempt	Tax	Exempt	Tax
Ohio	Exempt	Exempt	Exempt	Exempt	Tax
Oklahoma	Tax	Exempt	Exempt	Exempt	Tax
Pennsylvania	Exempt	Exempt	Exempt	Exempt	Exempt
Rhode Island	Exempt	Exempt	Exempt	Exempt	Tax
South Carolina	Tax	Exempt	Exempt	Exempt	Tax
South Dakota	Tax	Tax	Tax	Exempt	Tax
Tennessee	Tax	Exempt	Exempt	Tax	Tax
Texas	Exempt	Exempt	Exempt	Exempt	Tax
Utah	Exempt	Lower Rate	Lower Rate	Exempt	Tax
Vermont	Exempt	Exempt	Exempt	Exempt	Exempt
Virginia	Tax	Exempt	Exempt	Exempt	Exempt
Washington	Exempt	Exempt	Exempt	Exempt	Exempt
West Virginia	Tax	Exempt	Exempt	Exempt	Exempt
Wisconsin	Exempt	Tax	Tax	Exempt	Tax
Wyoming	Tax	Tax	Tax	Tax	Tax

* Five states—Alaska, Delaware, Montana, New Hampshire, and Oregon—do not impose general sales taxes on goods and services.

Sources: *1996 Guide to Sales and Use Taxes*, Research Institute of America, New York, 1996. *Sales Taxation*, Second Edition. Urban Institute Press, Washington, DC, 1994.

food purchased, rather than total purchases, and substantially narrow the tax base. There are more economical means of relieving the regressive nature of retail sales taxes, as discussed below under targeting tax relief.

It is important to note that states must exempt purchases made with federal food stamps from sales tax. This federal provision assures that a minimum level of food purchases by low-income families remains exempt from tax.

Include, in the General Sales Tax Base, Motor Fuels and Other Selectively-Taxed Goods

Some goods—such as motor fuels, tobacco products, and alcoholic beverages—are taxed selectively, using "excise" taxes. Levying such a tax implies that economic or social reasons exist for the government to place an extra tax burden on the consumption of the item. To then remove the item from the general sales tax defeats the excise logic.

Of the items commonly subject to excise tax but exempt from the general sales tax, motor fuels represent the biggest revenue loss. Only ten states tax the retail sales of motor fuel with the general sales tax: Arizona, California, Georgia, Hawaii, Illinois, Indiana, Michigan, New York, South Carolina, and West Virginia.

Most states do not exempt liquor and tobacco products from the general sales tax. Only Mississippi exempts alcoholic beverages. Virginia exempts state liquor store sales, and Colorado and Texas exempt cigarettes.

Re-examine State Tax Policies on Medicines and Health-Related Products

Exempting prescription medicines from sales taxation has considerable social welfare justification and is relatively easy to manage. All states provide tax relief on pharmaceutical sales in some manner.

Some states, however—including Florida, Maryland, Minnesota, New Jersey, New York, Pennsylvania, Rhode Island, and Illinois—have added over-the-counter medicines to prescription drug sales for tax exemption. In addition to reducing potential revenues from the sales tax, this policy creates tough definitional questions about what products fall into the exemption. For example, are face creams, baby oils, and shampoos health-related or cosmetic products? The exclusion of over-the-counter drugs also complicates application of the tax by vendors and creates difficult problems in administration.

Remove Exemptions for Clothing

A half dozen states—Connecticut, Massachusetts, Minnesota, New Jersey, Pennsylvania, and Rhode Island—exempt at least some clothing from retail sales taxation, presumably under the assumption that exempting necessities improves the fairness of the tax. However, there is ample evidence showing that the affluent spend relatively more on clothing than do people with low incomes. So, the exemption actually makes the sales tax more regressive. The exemption is also thorny to define and administer.

Treat Utilities like Other Goods

States vary widely in how they tax utilities purchased by residential customers e.g., electric, gas, water, and intrastate telephone (see Table 2-3). As this pattern indicates, there is no universally compelling rationale for exempting these purchases from the general sales tax.

Far fewer states tax interstate telephone charges, that is, telephone calls that cross state lines, than tax calls made within a state. Until 1989, there was serious

A BROAD OR NARROW SALES TAX BASE?

Consider This...	**Because...**
A narrow sales tax base requires higher statutory rates to raise necessary revenue.	● In 1994, the ten states with the narrowest-based taxes levied rates that averaged 0.5 percentage points higher than did the ten states with the broadest-based taxes (5.6% versus 5.1%). ● Long-term evidence indicates that tax rates for narrow-based taxes rise more rapidly than rates for broad-based taxes.
A broad sales tax base permits greater overall reliance on the sales tax for revenue.	● In 1994, the ten states with the broadest-based taxes collected 44.9% of their tax revenue from sales taxes, compared to 27.7% of tax revenue for the states with the narrowest-based taxes. ● Since sales taxes are generally more popular than income or property taxes, this should represent a political advantage.
Each percentage point of sales tax can raise much more revenue per capita from broad-based taxes than from narrow-based taxes.	● In 1994, the ten broadest-base state sales taxes each raised, on average, $134 per capita, compared to the $79 per capita raised by the ten narrowest-based taxes.
Broad-based taxes are somewhat less sensitive to economic recessions than are narrow-based taxes.	● Revenues from a more broadly based general sales tax will be more stable than if the tax is more narrowly based. ● The growth in the sales tax base and revenue that accompanies an increase in economic activity is somewhat higher for narrow-based than broad-based taxes.

Adapted from John L. Mikesell, "Fiscal Effects of Differences in Sales Tax Coverage: Revenue Elasticity, Stability, and Reliance," *Proceedings of the Eighty-fourth Annual Conference on Taxation of the National Tax Assocation*, 1991, p. 57.

question as to whether taxation of such telephone calls might violate the commerce clause of the U.S. Constitution. It has been legally found that it does not, but states have been slow to tap this tax base.

▼ *Extend Sales Taxes to Household Purchases of Services*

State and local sales taxes have historically applied generally only to purchases of goods. Sales tax coverage of service purchases has typically been much narrower, with only specific services subject to taxation.

As families increasingly spend their money on services rather than goods, this practice is causing states to lose revenue opportunities. The failure to tax services as heavily as goods may also be unfair to low-income families. That is, if higher-income families spend relatively more on services and less on goods, then the exemption of services from the sales tax increases the regressivity of the tax by placing a heavier burden on lower-income families relative to higher-income families.

How Do States Tax Services Currently?

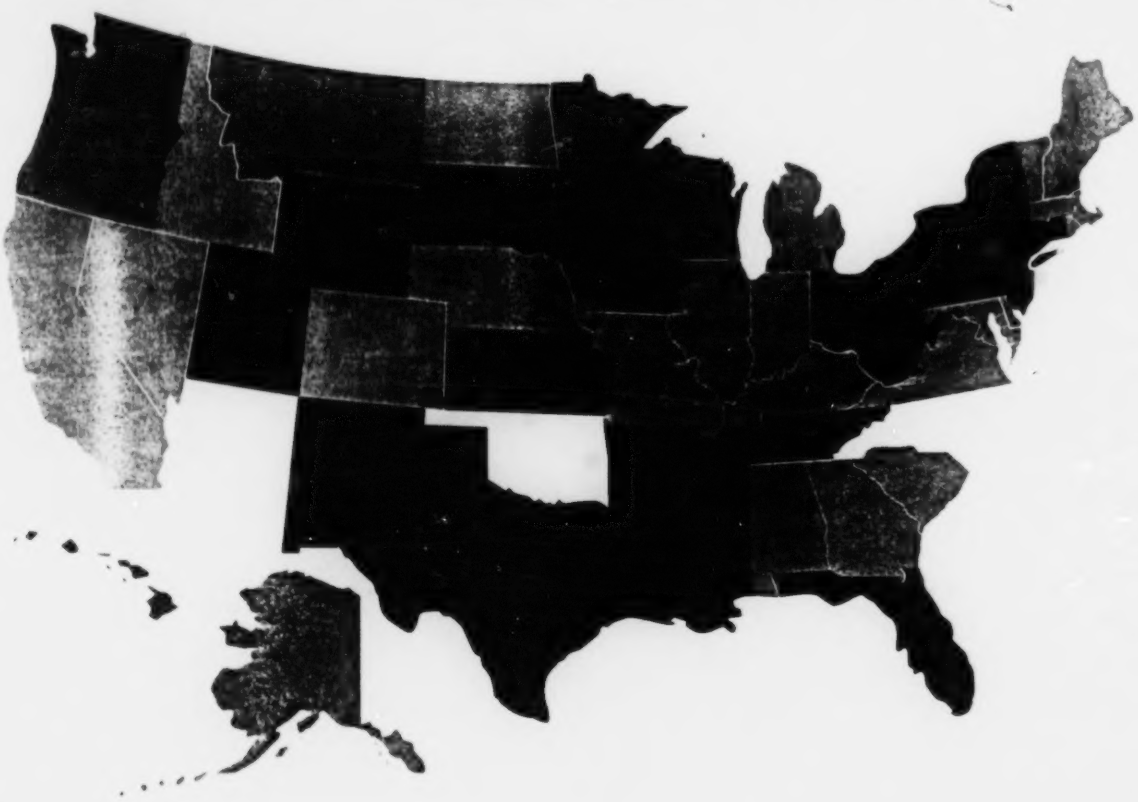
Only three states tax purchases of services on roughly the same footing as goods. New Mexico and Hawaii have done so since they enacted their sales taxes. South Dakota added services in 1979. But despite some attempts, no other states have been able to include all services.

Figure 2-1 divides the states into five groups on the basis of how extensively they tax the purchase of household services. Most states tax admissions, transient

FIGURE 2-1

SALES TAX TREATMENT OF SERVICES

Other Than Utilities, Admissions, Transient Accommodations and Rental/Leasing of Tangible Personal Property



- ▼ No Sales Tax
- ▼ Little/No Taxation of Services
- Limited Taxation
- ▼ Extensive Taxation
- ▼ General Taxation

Minnesota: repair and installation are not taxed.
Washington: services are generally taxed under the separate business and occupations tax.
South Carolina: laundry and dry cleaning are taxable.

Sources: *1996 Guide to Sales and Use Taxes*. New York: Research Institute of America, 1996. *Sales Taxation*, Second Edition. Washington, DC: Urban Institute Press, 1994.

accommodations, and the rental or leasing of tangible personal property. Beyond this, statesfall into five groups according to their taxation of services:

- *No sales taxation.* Five states—Alaska, Delaware, Montana, New Hampshire, and Oregon—do not impose general sales taxes on goods and services.
- *Little or no taxation of services.* In these states, governments primarily collect retail sales tax on purchases of tangible personal property (goods). A few selected services may be taxed by specific identification, but some of these states tax no services at all.
- *Limited taxation of services.* In these states, only a limited number of services that are specifically identified are taxed.
- *Extensive taxation of specific services purchased by households.* In these states, services to repair, install, and maintain tangible personal properties are taxed. These states also tax an extensive array of services performed for households, such as car parking, landscaping, pest control, laundry/dry cleaning, and cable television reception. However, medical, optical, and dental care; legal services; and other professional services seldom are taxed.
- *General taxation of all household service purchases, unless specifically exempt.* These states tax the purchase of services the most broadly. However, even in these states, certain services—such as those rendered by employees to employers, and financial transactions such as insurance transfers or mutual fund investments—are naturally excluded from taxation.

Over the years, taxing services selectively has proven far more feasible than efforts to tax all services. Florida and Massachusetts offer evidence of the ill fate of attempts to broadly extend the tax to services. In Florida, for example, there was so much political reaction to a new tax on services, especially on the part of one affected industry—advertising—with substantial power to influence public opinion, that the law was repealed within months of its enactment.

Expanding the sales tax to services incrementally has been a more successful strategy for states. For example, in 1992, a number of states added particular services to the base (see box).

INCREMENTAL EXPANSIONS OF THE SALES TAX ON SERVICES: FOUR STATES' ADDITIONS IN 1992

Florida Florida Laws: Chapter 92- 320	Security services Nonresidential cleaning Pest control
Maryland Maryland Laws: Chapter 92-(1-3)	Security services Nonresidential cleaning Cellular phone services Credit reporting Telephone answering services
Iowa Iowa Laws, 1992: Section 443.43	Sign construction services Dating services Limousine service Nonresidential sewerage service Storage Swimming pool maintenance Taxidermy service
District of Columbia Laws, 1992: S.F. 2034	Laundering service Dry cleaning, pressing services Cable television

Taxing purchases of certain types of services appears promising as a source of raising new revenue and increasing the fairness of the sales tax without increasing the tax rate. Any service sold primarily to households is a potential candidate for sales taxation. The following sections briefly discuss several feasible options for expansion.

Taxing purchases of certain types of services appears promising as a source of raising new revenue and increasing the fairness of the sales tax without increasing the tax rate.

Include Services Related to Taxable Goods

Governments could tax the repair, installation, maintenance, storage, cleaning, laundering, and related services done to goods that are themselves taxable, as well as tax services provided in conjunction with the sale of those products. For example, the delivery, installation, and cleaning of home or office furnishings such as carpeting or computers could be taxed.

Extend the Tax Base to Encompass Cable Television

Governments could apply sales tax to basic cable television charges. Fewer than half the states currently tax this service under the sales tax. These include Arkansas, Connecticut, Florida, Hawaii, Indiana, Iowa, Kansas, Minnesota, Mississippi, Nebraska, New Mexico, Rhode Island, South Carolina, South Dakota, Texas, Vermont, West Virginia, and Wisconsin. Maine taxes premium services and Maryland taxes pay-per-view sales.

Collect Sales Tax on Personal Services

Governments could tax services performed for individuals by businesses, including services of barbers and beauticians, veterinarians, and recreational instruction.

Consider Taxing Professional Services

The work of physicians, dentists, lawyers, accountants, casualty insurers, and other professionals could be taxed, but states have been reluctant to do so. Often, this is for social or political reasons. For example, states may not want to be perceived as increasing the cost of medical care by taxing health care services, particularly near election time.

Taxing other types of professional services can create difficult problems in distinguishing between the purchase of such services by households, which should be taxed as part of consumption spending; and the purchase of these services by businesses, which many experts believe should not be taxed because such taxation causes economic distortions. In general, applying sales tax to business purchases—whether of goods or of services—creates an incentive for firms to perform work in-house rather than purchasing it from outside. This tends to give big businesses an extra economic advantage over small businesses. In addition, it causes uneven, haphazard tax burdens among businesses, many of whom must assume additional costs or pass on the increase in costs to consumers. This can place a jurisdiction at a disadvantage for economic development.

▼ *Constrain Vendor's Discounts*

There is another option for increasing sales tax revenue that does not involve changing the legal definition of the sales tax base or increasing the statutory tax rate. More sales tax revenue, regardless of whether it is generated by taxing purchases of goods or services, can be raised by constraining vendors' discounts.

More than half the states allow vendors to retain a portion of the sales tax they collect. These policies are based on two rationales: compensating the vendor for collecting the tax and providing an inducement for them to remit the tax when it is due.

Vendor discounts can potentially result in considerable state revenue loss—in Virginia, for example, some vendors are permitted to retain as much as 4 percent of their sales tax collections.

A growing number of states have begun to limit the amount that vendors can retain by instituting a variety of reforms. For example, some states have established a diminishing discount rate, which decreases with the amount of revenues collected by vendors. Some states limit the total amount that vendors can retain in a given reporting period. Other states take the position that sales tax compliance is a normal business cost that the vendor is expected to manage as a part of overall operations, and thus have eliminated the discount entirely.

Some experts warn that the amount of revenue generated by this option may be small compared to that potentially generated by other options. In addition, pursuing this option can be politically difficult, creating substantial opposition from business owners.

▼ Option 2: Broaden the Income Tax Base

Individual income taxes are as important to the finances of state governments as retail sales taxes. To illustrate this point, personal income taxes in 1993 generated 24.1 percent of state government tax revenue, compared to 24.6 percent raised by general sales taxes. In states that authorize their use by local governments, income taxes also are an important revenue source for some local jurisdictions, particularly cities. Thus, broadening the income tax base is another important revenue generation option for state and local governments to consider. It has many of the same advantages discussed above for the sales tax: keeping tax rates lower, increasing increase revenue yields, improving fairness, and increasing efficiency.

Two options that states or local jurisdictions should consider are re-examining the link between the state and federal tax systems, and investigating opportunities to establish a local income tax supplement to a state tax.

States or local jurisdictions should consider re-examining the link between state and federal tax systems, and investigating opportunities to establish a local income tax supplement.

▼ *Reconsider Linkages Between State and Federal Tax Systems*

Strong linkages exist between state income tax systems and the federal tax structure, although some states model federal policies and practices more closely than others. For example, states link their collection processes to those of the federal government, and partner in federal audit and enforcement activities to ensure that citizens accurately pay the state taxes they owe. Most importantly, states link their tax bases to the federal income tax base by adopting federal definitions of income tax elements (such as adjusted gross income or taxable income) and instructing taxpayers to report the same amounts of those items on their state tax forms as they report on their federal income tax returns.

Depending on the point at which a state links its income tax to the federal income tax, it leaves itself with greater or lesser flexibility to define its own tax base and broaden the tax base. Of the 41 states and the District of Columbia that have general individual income taxes, most states link to the federal tax structure at one of three general starting points: federal adjusted gross income, federal taxable liability, or federal tax liability.

Link to Federal Adjusted Gross Income: Maintaining the Greatest Flexibility

The majority of states—27—use federal adjusted gross income as a starting point in defining their income tax bases. This practice allows them to follow federal definitions of income, which is practical administratively, but also to develop their own standard deductions, personal exemptions, tax rates, etc. It also enables them to keep the tax base broader by choosing whether to copy—or modify—federal tax preferences. These preferences include itemized deductions (such as those for certain state and local taxes, mortgage interest, medical expenses, charitable contributions, and casualty losses) and income exclusions (from sources such as unemployment compensation payments, certain retirement income, certain savings for retirement, and interest received from state and local bonds). Thus, using this starting point, a state can preserve its revenue options—including the potential for pursuing a broad tax base/low statutory rate strategy.

ISSUES RAISED BY LINKS CLOSE BETWEEN STATE AND FEDERAL TAX PROVISIONS: THE EXAMPLE OF DEFERRED TAXATION OF RETIREMENT INCOME CONTRIBUTIONS

Background

- Federal tax law lets individuals exclude contributions to certain retirement plans from income that is taxed. Tax is collected when the individual retires, so the retiree is able to earn interest or other returns on that money—including the amounts that would have been paid in taxes—over time.
- The federal government delays collection of its tax to encourage people to save for retirement—and states generally follow the same policy in their income tax systems. While this provision may help people prepare for retirement, it also may seriously compromise states' abilities to generate revenue.

The Federal Challenge

- Recent federal legislation drastically limits states in taxing pension income of former residents.
- The national Pension Income Taxation Limits Act prevents a state in which pension income was earned from "source taxing"—that is, from reaching beyond its borders to tax the income of former residents when they collect retirement income based on their work life in that state.[2]

State Ramifications

- Workers can avoid state tax on retirement income—including income from pensions and individual retirement accounts (IRAs)—when the income is earned. By moving, they can avoid state tax on retirement income when it is paid.
- Several popular retiree-destination states—e.g., Florida, Nevada, and Texas—levy no individual income tax, so there is considerable potential loss of revenue to state governments as a whole.

Options for States

- Accept that certain income tax revenues will be lost by tying state tax provisions to the federal tax provisions.
- De-link state taxes from federal tax provisions. For example, remove or reduce exclusions for pension contributions at the time income is earned. Another option is to de-link the tax treatment of IRAs. Like pensions, funds placed in IRAs enjoy preferential tax treatment to encourage savings (even though these funds may be drawn down before retirement under certain conditions). This creates a stronger case for taxing the income when it is earned.
- Lobby the federal government to adjust the national Pension Income Taxation Limits Act so that it does not deprive states of justifiable revenue.

Link to Federal Taxable Income: Opportunities to Broaden the Tax Base

A small number of states—7—accept most aspects of the federal tax base, including standard or itemized deductions and exclusions from income, but apply their own personal exemptions and tax rate structure. These states have significant opportunities to broaden their tax base by linking less closely to the federal income tax structure. When considering ways to enlarge the income tax base to better fund children's programs, states should examine the federal exclusions and deductions they have copied to determine whether they are consistent with state preferences and whether they are worth the lost revenue. Even if the state chooses to continue piggybacking on certain federal tax provisions, it can also consider reducing the size of allowable exemptions, deductions, exclusions, and credits.

Link to Federal Tax Liability: Opportunities to Restructure State Income Tax

In three states, the state tax is computed as a percentage of federal tax liability. These states have implicitly adopted all aspects of the federal income tax structure—including the tax base as well as the rate structure—as state tax policy. Thus, to the extent that they can de-link their state income tax from the federal income tax, these states have the most opportunities to broaden the state tax base and restructure their income taxes to reflect state preferences.

▼ *Piggyback Local Income Taxes on State Taxes*

Most local governments with income taxes do not tie their income tax structures to the federal system and its relatively broad income definitions. Rather, they typically base income taxation on wages and salaries, often by taxing the payrolls of employers. Sometimes local income taxes include other "earned" income (such as income from unincorporated businesses and rentals). Most often, they tend to omit "unearned" sources of income (such as interest, dividends, and capital gains) from their tax structures, in part due to the problems associated with trying to enforce these provisions.

A good option for broadening local income tax bases is to restructure these taxes as local supplements to the state income tax, which local jurisdictions can choose to adopt or not. This would increase the local tax base considerably and spread the tax burden more equitably across all types of income.

Such piggybacking of taxes can prevent costly duplication of tax administration by various levels of government and compliance efforts by taxpayers. This is particularly true if state administration is required, as it is in Indiana, Maryland, and some other states. Local piggybacked taxes also can be structured to tax non-residents working in the local jurisdiction and channel revenues based on employment location, similar to local wage and salary taxes. For example, Indiana divides local income tax collections between the localities where commuters reside and where they work.

▼ Option 3: Limit Revenue Losses from Exclusions to the Property Tax Base

Property taxes—mostly levied on real estate—are a particularly important revenue source for school districts and other local governments. Thus, they are an important element in the financing of services to children.

In the aggregate, local governments collect about three-fourths of their tax revenues from the property tax. They often lose portions of their potential property tax base, however, because the state has mandated full or partial exemption of the value of certain properties. When localities grant exemptions, they tend to use similar criteria for excluding properties from the tax rolls. The sidebar exhibit lists several types of exemptions commonly granted.

No credible estimate exists of the amount of property lost from tax rolls, or the foregone tax revenue resulting from property tax exemptions. Nevertheless, these exemptions can be a significant loss to the tax base. In 1991, for example, residential property tax exemptions granted to certain groups of owners accounted for nearly 5 percent of the nation's gross property tax base. It exceeded 10 percent in six states: Alabama (12.3%), Florida (14.1%), Hawaii (13.4%), Idaho (15.0%), Indiana (10.6%), and Louisiana (27.5%).[3]

COMMON STATE AND LOCAL PROPERTY TAX EXEMPTIONS

States Frequently Exempt:	Such As:
Property Used for Public Purposes	Religious, educational, charitable, and government-owned properties.
New Business Investments	Industrial plants and other business and corporate property that is exempt for specified periods of time to encourage economic development.
Sites Achieving Environmental Objectives	Property under rehabilitation or used for pollution control/abatement and energy conservation.
Personal or Moveable Property	Machinery, equipment, raw materials and inventory, household effects, motor vehicles, etc. This property is almost always excluded when owned by private individuals and widely excluded when owned by businesses.
Residential Property Owned by Certain Groups of Persons	Homestead property, property owned by veterans, senior citizens. These are often partial rather than full exemptions.

When properties are excluded from the tax base, governments lose revenue. This also means that properties not exempted from the tax actually pay higher taxes than they otherwise would, just to make up the difference.

▼ *Reconsider Benefits and Costs of Tax Exemptions*

As state and local officials consider options to regain revenue lost from narrowing the property tax base, they should calculate whether the objectives achieved through various tax exemptions are worth the sacrificed revenue. In addition, they should consider that property tax programs to relieve burdens on individuals often can be replaced with better-targeted, less expensive circuit-breaker programs. Circuit-breaker programs are discussed later in this chapter.

▼ *Regain Lost Property Tax Revenues from Tax-Exempt Organizations*

As indicated above, state and local governments relieve many educational, cultural, charitable, governmental, and other non-profit organizations of property, sales and use, or income tax liability. Many non-profit organizations provide services that would otherwise need to be financed by government, thus freeing up public dollars for spending elsewhere. Indeed, some of these organizations deliver important services to children that might otherwise need to be financed out of public funds.

Nevertheless, governments must take care not to undermine their own capacity to deliver services to children and others that are financed by their revenue systems. Revenue lost in full or in part through tax exemptions to non-profit organizations can be a particularly acute problem for local governments, especially for older cities that often host a concentration of these organizations. The fiscal impact of exempt federal installations and property is also considerable in some sparsely populated western states. Because these tax-exempt entities receive general and specific government services, yet do not contribute to the property tax base, host governments can experience real financial stress from their presence.

Thus, one way to limit revenue losses is to recapture property tax revenues from tax-exempt organizations. In evaluating any of the options outlined below, however, governments must balance the benefits returned by the non-profit sector against the costs of the revenue lost. They must also avoid creating unfair competition between non-profit and tax-paying organizations.

Narrow Tax Exemptions

Governments can re-evaluate the appropriateness of granting tax-exempt status to certain organizations. In so doing, they should ensure that the public benefits provided by the organization are great enough to justify the granting of tax exemption and the revenue lost through the exemption.

Impose Service Charges

Governments can make up for revenues lost through tax exemptions by charging fees for some services they perform. Revenues received through fees free up tax dollars for other purposes. State and local governments can:

- *Levy a "core service fee."* Some states and localities levy an essential services fee on tax-exempt organizations to help support basic public services such as police protection, and street maintenance.
- *Charge for certain public services.* Some localities are experimenting with imposing special fees on tax-exempt organizations in order to support particular services. Rochester, New York, for example, charges tax-exempt institutions a fee for services, such as street cleaning and sidewalk maintenance, that is based on street frontage.[4]
- *Charge true prices for public services.* Localities also should consider charging users—both exempt or taxable users—the actual, unsubsidized costs of public services. This option is most suited to services where usage can be easily measured and tracked and the benefits accrue principally to the user, for example, solid waste management, protective alarm connection services, or water and sewerage services.

Require Payments in Lieu of Taxes

Some states have formal arrangements for particular exempt institutions to pay certain payments in lieu of property taxes.[5] This option results in replacing some or all of the portion of property taxes that would have been paid if the property were not exempt. The programs seldom fully replace the tax revenue lost, but they relieve some distress in areas with extraordinary impact from exempt institutions.

Nearly half the states use this approach, including: Colorado, Connecticut, Illinois, Iowa, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, Nevada, New Hampshire, New Jersey, New York, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Utah, Vermont, and Wisconsin.

Negotiate Voluntary Payments in Lieu of Taxes
States and localities can opt to negotiate voluntary payments or receive in-kind contributions such as capital equipment from tax-exempt organizations. A university might agree to purchase fire-fighting equipment appropriate to tall-structure fires on its campus, for instance. But such transfers are rare, and seldom seen as fully adequate by the recipient governments.

STRATEGY 2: ALIGN REVENUES WITH NEW ECONOMIC AND DEMOGRAPHIC REALITIES

In order to capture a greater portion of current economic activity, to create a fairer distribution of taxes, and to avoid unnecessary harm to the private economy, state and local revenue systems should be responsive to key structural shifts in the economy and population. Many states and localities need to make structural and administrative changes in their tax systems to better align them with today's economic and demographic situations.

How do public revenue systems stack up to the rapidly changing world in which we live? Current state and local revenue systems tend to be designed for a fixed-site manufacturing environment. Economic activity, however, increasingly takes the form of service transactions and straddles state and national boundaries. This disconnect between current service-oriented interstate and international economic activity, and the revenue systems that were built for a locally based manufacturing economy, fails to make revenue systems as efficient, effective, or equitable as possible.

In addition, property tax appraisal systems have been slow to adopt new technologies that can better measure property values, even as the need for better valuation becomes more critical. Considerable property value growth and significant variations across the years, among types of property, and among neighborhoods have made the jobs of property tax assessors increasingly difficult.

And, under extreme competitive pressure, governments are granting tax preferences to new and expanding businesses in the name of economic development; this reduces the primary tax bases of state and local governments without necessarily providing the promised benefits.

This section presents five options that address these and other trends, offering states and localities opportunities for better aligning their revenue generation systems with current economic and demographic realities.

▼ Option 1: Expand Tax Collections from Interstate Sales

The federal constitution prevents states from applying sales taxes to purchases made out of state by their residents. As a result, states with sales tax rates higher than their neighbors have always worried about losing business and sales tax revenue to their neighbors.

To protect against their loses, states devised the *compensating use tax*—a tax on the use of items purchased without payment of the sales tax. The use tax applies at a rate sufficient to fill the gap between the state sales tax and the rate previously paid to another state. The tax is therefore intended to deny shoppers any advantage from purchasing items in low- or no-tax areas.

In constitutional terms, as long as the compensating use tax simply offsets missed sales tax, there is no problem. However, administration, not legality, is a problem. Purchasers seldom volunteer the tax owed, and out-of-state businesses seldom want to collect a tax intended to eliminate any competitive advantage the tax structure might give them.

Furthermore, states now have a new worry. How do they apply their tax to catalog sales, goods bought from telemarketers or television advertisements, purchases made over the Internet, and other transactions that involve no physical presence of the vendor within the state?* As such commerce without physical presence grows, the capacity to enforce state use taxes becomes more important. Without the use tax, the sales tax base and local businesses both suffer. Estimates place lost state sales and use tax revenue at more than three billion dollars and growing.[6]

The U.S. Constitution offers states two alternatives to this problem. The first is to convince Congress to pass a law authorizing states to require vendors who sell within their boundaries, but do not have a physical presence in the state—in other words, those vendors who have considerable and continuing economic presence within the state—to register and collect their taxes. The second alternative is to continue attempts to collect use taxes from buyers who purchase products from those unregistered out-of-state companies.[7] In the absence of federal action, states have several options to increase their effectiveness when collecting taxes on interstate transactions, including sales made by mail or other means.

Many states and localities need to make structural and administrative changes in their tax systems to better align them with today's economic and demographic situations.

▼ *Invite Voluntary Collection by Sellers*

States can actively encourage out-of-state businesses to voluntarily collect the tax on their sales. The tax is added to the price paid by customers, and business accounting systems can easily manage the tax, so burdens on those that volunteer to collect the tax are slight. As an added incentive, states can choose to allow these businesses to retain a small, but potentially profitable, percentage of these collections to compensate them for their efforts. In considering offering such *vendor discounts*, however, states should consider the revenue loss they entail and various designs for limiting this loss (discussed earlier in this chapter).

▼ *Identify Untaxed Activity by Exchanging Information with Other States*

Many states exchange information found through audits or in other compliance activities about the activities of businesses in other states. They have found this information useful in providing lists of customers who can be billed for taxes owed. Information exchange can also help establish lists of businesses that may be approached to register as tax collectors.

▼ *Identify Foreign Purchases through Customs Declarations*

Many states obtain customs declarations information from the federal government. They are then able to use this information to submit use tax bills to people bringing high-value foreign purchases into their jurisdictions.

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*Some out-of-state businesses must register to collect the tax because they have physical locations within the destination state. For instance, some catalog companies also have retail stores. Physical presence in the destination state allows that state to require the vendor to register to collect on deliveries into the state, even if the transactions are otherwise interstate.

▼ *Enforce Use Taxes on Licensed and Other Items*

States can take the opportunity to enforce their use tax when the item purchased must be registered or licensed within the state. For instance, if a motor vehicle is purchased out of state, the use tax on that purchase can be applied when the vehicle is licensed in the state of the purchaser.

▼ *Stimulate Voluntary Payment of Use Taxes*

A number of states have created a way for purchasers to voluntarily report and pay use taxes owed. This involves adding a line on the state personal income tax return for volunteering the amount of use tax owed on purchases made out of state in the past year, usually purchases made from catalog sellers without outlets in the state.[8]

▼ Option 2: Keep Property Assessments Current with Market Values

The property tax also needs to keep up with changing economic and demographic patterns by reflecting changing property values. This reflection takes place through the assessment process, in which property values are estimated for tax purposes.

Many states define current market value as the legal standard for assessing property under the real property tax. But prevailing practice often puts the assessed value of a piece of property considerably below its current market value. There are several reasons for this difference: sometimes it is because state law requires assessment at a fraction of market value. Other times state law has broken the link between assessed value and market value. And sometimes it is because of inadequate property assessment administration. In most of the United States, the property tax base would increase considerably if government tax assessors valued properties at ratios closer to current market value.

Increasing the property tax base by assessing properties closer to market value has several advantages. It would not necessarily generate more government revenue, because evidence shows that government officials and the public tend to demand that tax rates fall when assessments rise. But raising even the same amount of revenue with lower tax rates is good policy because it can lessen the economic distortions that higher rates induce.

Increasing the assessed value of property would also mean greater flexibility for jurisdictions where debt limits are tied to assessed value and where local governments face legally frozen property tax rates—unless, of course, the laws setting those limits were also adjusted.

Even if the market values of properties fall, which they sometimes do as companies decline and economic activity shifts, it is advantageous to reflect this with accurate current assessments. Assessment systems that are not driven by the market—that "preserve" the tax base as market values decline—actually penalize individual property owners whose parcels have fallen in value, possibly accelerating their financial collapse. Keeping tax values artificially high is no economic or fiscal bargain.

Beyond more accurately reflecting the current property tax base, higher ratios of assessment-to-market value almost certainly improve assessment equity. Properties of comparable value are less likely to be assessed at different values and thus pay different property tax when assessments are closely tied to market value.

Governments have several options to make property assessment more accurately reflect current market values:

▼ *Define the Assessment Standard as Full Market Value*

Make full market value, not some fraction of it, the standard for assessment. Ensure that the standard specifies that market values be current.

▼ *Reassess Regularly*

Require a frequent, but not necessarily annual, cycle for reassessment based on physical inspection of all properties.

▼ *Allow Assessors to Use All Standard Approaches to Estimating Market Value*

Accepted techniques for assessing property include approaches that estimate value based on comparable sales, capitalized income, and cost summation. Allow assessors to take advantage of the full range of standard approaches, rather than being restricted to a particular approach that may not be well suited for a specific parcel.

▼ *Make Better Use of High Technology*

Provide assessors with modern technological tools to accomplish their task. New technology can assist in better information processing and management, professional proficiency, and regular evaluation of assessment work.[9]

▼ *Maintain Openness in the Property Tax System*

Help citizens better understand how their property taxes are determined, how they can raise informed protest, and how they can compare assessment of their property with others. (See Chapter 6: *Building Support For Finance Reform.*)

▼ *Formalize Any Property Tax Relief*

Legislate formal property tax relief for groups of taxpayers, such as the elderly and urban farm owners, if relief is deemed necessary. Then assessors are not tempted to grant ad hoc, non-systematic assistance. (See later section in this chapter on maintaining revenue yield while targeting relief.)

Tax abatement may or may not have an impact on a company's decision to expand operations, relocate, or build a new plant, but it will almost definitely result in lost tax revenue to the host jurisdiction.

▼ Option 3: Reconsider Conditions for Tax Abatements to Businesses

State and local governments often reduce or forgive taxes to particular businesses in order to encourage them to locate new or expanded operations in their jurisdiction. While governments can point to facilities developed with the assistance of certain tax abatement packages, it is difficult to determine what role—if any—abatements have in business decisions. Indeed, evidence shows no clear and substantial influence of tax incentives on economic development. Nevertheless, if government officials do not offer tax incentives and a business locates elsewhere, the officials may be politically embarrassed—even though their efforts may not have changed the final decision.

What is clear, however, is that tax abatements for business cost tax revenue: the effects of development are not usually large enough to outweigh the revenue given away through the incentives.[10] Tax abatement may or may not have an impact on a company's decision to expand operations, relocate, or build a new plant, but it will

STRATEGY 2: ALIGN REVENUES WITH NEW ECONOMIC AND DEMOGRAPHIC REALITIES

almost definitely result in lost tax revenue to the host jurisdiction. And lost revenue means less revenue available for financing education and other services to children. Decisionmakers should consider the following two options in re-examining their tax abatement policies:

▼ *Negotiate a Tax Competition Truce or a Common Disclosure Agreement*

State and local leaders should consider negotiating a tax competition truce. Such an agreement would eliminate competitive bidding among states or communities. In so doing, it would have positive benefits for all states or communities by reducing the actual or potential revenue lost though tax abatements.

Despite the considerable fiscal advantage such a truce would bring, state and local governments have been unwilling to stop offering competing tax favors to businesses. Even with the uncertain evidence of the effectiveness of abatements and other tax favors in inducing economic development, government officials face tremendous competitive pressure to make such offers.

One method for increasing knowledge and understanding of the implications of tax abatements is for all states to negotiate a common disclosure agreement. Such an

A SELF-ENFORCING GUARANTEE FOR ECONOMIC DEVELOPMENT INCENTIVES: PRINCETON, INDIANA

The Incentive Opportunity

- In November 1995, Toyota selected Princeton, Indiana, as the location for its new $700-million plant for the construction of the T 100 pickup truck. The plant offered about 1,300 high-paying jobs in an area with many laid-off miners who once worked the Illinois Basin coal fields.
- The state provided $29.8 million in incentives, including cash payment, infrastructure improvements, and training. Local government abatements, infrastructure development, and other programs brought the incentive package to $75 million.
- But Princeton is near the border with Kentucky and Illinois. How could Indiana make sure that the jobs promised in the aid package came through, or that Indiana workers—not those from the neighboring states—were hired for the jobs?

Clever Design of The Incentive Package: A Self-Enforcing Guarantee

- About half of the state incentive is from the Indiana EDGE Program—Economic Development for a Growing Economy. Under the program, Toyota receives the 3.1 percent state income tax paid by its employees for ten years, which provides about $15 million of the total aid package.
- But Toyota doesn't get the money unless the workers are hired. And Toyota won't get the money if the employee lives in a state other than Indiana.
- The strategy automatically enforces a link between the promised employment and the incentive package—because the tax on those salaries funds the aid. It also helps ensure that Indiana workers will get the jobs brought by the state incentives—because Toyota gets credit only for Indiana personal income taxes.
- The Indiana clawback provision is controversial: some even argue it may be unconstitutional because it discourages interstate commerce. Nevertheless, the example illustrates the creativity that states and communities can use when designing these provisions.

agreement would heighten public awareness of the size of the incentives on a state by state as well as national basis and may provide a valuable tool for mobilizing community support in favor of keeping tax abatements to reasonable levels.

▼ *Protect Against Unfulfilled Promises*

Many governments now use "clawback" provisions in conjunction with tax abatements in order to try to ensure that the citizens of the jurisdiction reap the promised benefits from their investment in new business development. That is, governments offer business incentives to relocate or expand only on the written understanding that the firm will either create or retain a certain number of jobs over a defined period—and that if it doesn't, it must make some compensating payment to the state.[11]

Unfortunately, clawbacks are no panacea. States have found clawbacks hard to enforce because of difficulties interpreting whether promises have been kept, and the reluctance of many state and local leaders to take a hard line with businesses. However, the number of states experimenting with these provisions has risen in recent years. In 1989, only two states attempted to provide such fiscal protections, but 29 states now seek some protection against unfulfilled promises.[12] Connecticut and Indiana (see box) have particularly strong provisions.

▼ Option 4: Re-examine Taxation of Multistate and Multinational Businesses

The operations of businesses today often span many taxing entities. For example, a corporation may have facilities throughout the nation and the world for manufacturing, assembly, distribution, sales, and central administration. In these cases, how much of total business profit ought any one of these locations tax? No accounting scheme can fairly allocate company-wide profit to each discrete location, so some formula provides the best solution.

The choice of formulas has important ramifications not only for the businesses involved, but also for states' revenues. If corporations do not pay appropriate taxes, states will have a more difficult time financing their services, including education and other services to children.

▼ *Use A Traditional Three-Factor Formula*

Many states have traditionally determined the share of business profits that should be taxed within their state by applying an apportionment formula. This formula allocates total firm profits to a state using an average of the shares of property, payroll, and sales occurring in that state. For manufacturing and other enterprises with fixed physical locations, the process usually produces defensible results.

▼ *Create New State-Specific Formulas*

Many businesses and experts argue that the old three-factor apportionment formula may not be appropriate for the growing forms of service- and knowledge-based economic activity that are conducted with minimal physical property. In response, some states have changed the formula for all businesses, often by double-weighting the sales factor in the apportionment. Other states have adopted special apportionment formulas for certain industries (e.g., broadcasting, banking, interstate transportation). In addition, to stimulate economic activity within their borders, states have created special formulae to reduce corporate taxes at least on certain businesses.[13]

While updating the traditional three-factor formula may be warranted to address changes in the structure of businesses, this option should be treated with extreme caution. As with many formulas, formulas for apportioning profit between states are complex and their effects are not widely understood. Business may lobby for changes which have little economic rationale but provide businesses with considerable benefits, in the form of reduced taxes. Thus, states should be aware of the fact that there is considerable potential for business to get large, unnoticed tax breaks if the formulas are not altered in a meaningful manner.

If corporations do not pay appropriate taxes, states will have a more difficult time financing their services, including education and other services to children.

▼ *Adopt Uniform State Taxation of Business*

Because of the different approaches that states have adopted, it is quite possible that some businesses operating in multiple states will be taxed on more than 100 percent of their income and others will be taxed on considerably less. Differences in state formulas also permit firms to arrange their operations across the states so that higher shares of total profit will be apportioned to "low tax" or "no tax" states. Adopting uniform rules for taxing multistate businesses offers the potential of eliminating this revenue loss for states, as well as simplifying the compliance burden for business.[14]

▼ *Pre-empt Multinational Shifting of Profits*

The complexities of taxing business operations fairly and appropriately are even greater for corporations that extend beyond national borders. If a domestic corporation is owned in common with a foreign corporation, U.S. profits—the base to which apportionment will apply—can be manipulated by having the domestic U.S. corporation pay artificially high "transfer prices" for goods or services it receives from the affiliated foreign corporation.

States once prevented this possible abuse by using a *worldwide unitary combination method* for profit reporting, so that taxable profit could not be moved out of their reach. In other words, the starting point for calculation of corporate profit included the profit of the entire corporation, both foreign and domestic portions together, and apportionment established how much of the total would be taxed in the particular state. But various pressures, including competitive threats and concerns about American foreign policy, ended that approach in the 1980s.

Because states usually pattern their corporate income tax base after the federal base, definitive and aggressive federal regulation of transfer pricing would significantly help states guard their corporate profit tax base as enterprises become even more global in operations and ownership. If states will not return to treatment of the global corporation as a single unit, regardless of national subsidiaries, their only protection is federal action on transfer pricing.

▼ Option 5: Incorporate New and Changing Industries into the Tax System

Advances in technology and strong market competition have given rise to innovative industries, products, and ways of doing business. Some examples are new telecommunication products and companies, redesigned financial services, and industries such as transportation and energy that have reorganized in response to regulatory changes.

How can state and local governments make sure that these changing industries bear their appropriate share of the cost of government services? States have experimented with two major approaches.

▼ *Include Changing Industries in the General Tax System*

Some states have worked to include new and rapidly changing industries in the general tax system—that is, taxing them under existing business profit, sales and use, and property taxes. Bringing industries into a single general tax structure is generally considered to protect economic development and the tax base because it allows the tax system to avoid accidentally playing market favorites.

▼ *Re-evaluate Special Gross Receipts Taxes*

States have typically levied gross receipts taxes on industries where little competition existed, such as in the utility and telecommunication sectors. For example, Florida levies a special gross receipts tax on utilities.* The special treatment generally originated when several of these industries were under narrow regulatory control because of the monopoly they had been granted in a particular service area. Recent changes in technology and accompanying legislative changes have increased the number of firms competing for business in some of these markets.

Given these changes, states should re-evaluate their policies on gross receipts taxes. In some instances, these taxes may continue to be appropriate. In these cases, special gross receipts taxes that no longer be imposed on companies which no longer have monopoly power. Continuing the special taxation once these monopolies have ended can create dramatically different tax treatment for businesses competing in the same market.

STRATEGY 3: DIVERSIFY AND BALANCE REVENUE SYSTEMS

Abnormal reliance on any revenue source—that is, raising an unusually large share of revenue from the sales tax, income tax, property tax, or other revenue source, usually by imposing high effective tax rates—accentuates the imperfections of that tax. High tax rates place extraordinary burdens on people and businesses paying that tax, create significant economic distortions as businesses and individuals respond to the tax, and make tax evasion and avoidance appear attractive. Attempts to correct such problems often complicate the tax and may end up imposing even higher tax rates on some taxpayers.

A revenue system that is diversified and balanced—using all the major revenue sources without placing extraordinary reliance on any one of them—holds many advantages. In such a revenue system, defects in one tax may be naturally accommodated or offset in other segments of the tax system, without having to attempt complex changes in the tax that initially created the problem.† For example, a diversified and

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*Florida's gross receipts tax on utilities is earmarked for state education bond repayment. Money from those bond issues goes to school districts on a population formula. See Chapter 3: *Better Budgeting* for a discussion of revenue earmarking.

†Instability of a particular tax, however, can be a problem if that tax is earmarked for support of a particular function and represents a major share of total financing for that function (discussed in Chapter 3: *Budgeting Better*).

balanced revenue system offers the best possibility of keeping tax rates low, thus minimizing economic distortions. It can also produce a more stable revenue stream, as taxes that are more responsive to economic cycles are offset by revenues that are less responsive. And it can mitigate the regressive nature of certain revenue sources, such as the sales tax, by including more progressive elements, such as an income tax.

Some states, however, have special conditions that make a preference for unbalanced tax systems more reasonable. For instance, the state of Nevada, with its large casino- and tourist-based industries, makes particularly heavy use of taxes designed to export a considerable cost of government to visiting tourists. But that is an exception; most state and local governments will be better off with a more balanced fiscal system.

Table 2-4 shows which states use each of the major taxes, and which have chosen to omit one or more of them. While most states raise money by taxing individual and corporate income, retail sales, and property, a few vary from the norm and levy slightly different broad-based taxes on business activity. These include taxes in New Hampshire and Michigan that resemble value-added taxes, and the business and occupation tax in Washington that is a vestige of general gross receipts taxation from an earlier era.[15]

TABLE 2-4

MAJOR TAX SOURCES OF STATES AND LOCALITIES

Tax	Levied by State Governments in...	Levied by Local Governments in...
General Property	22 states	50 states and the District of Columbia
General Sales	45 states Washington also levies a multi-rate gross receipt tax (the business and occupation tax). Exceptions: Alaska[a], Delaware, Montana, New Hampshire, and Oregon.	33 states and the District of Columbia
Individual Income	41 states Exceptions: Alaska[a], Florida, Nevada, New Hampshire[b], South Dakota, Tennessee[b], Texas, Washington, and Wyoming.	16 states and the District of Columbia
Corporate Income	44 states New Hampshire levies a business enterprise tax, a modified value-added tax. Exceptions: Michigan[c], Nevada, South Dakota, Texas[d]. Washington, and Wyoming.	6 states and the District of Columbia

[a] No statewide tax; however, various municipalities and boroughs levy a sales tax.
[b] New Hampshire and Tennessee tax dividends and interest.
[c] Michigan levies a single business tax, a modified value-added tax.
[d] Texas has an earned surplus component of its corporate franchise tax that is very close to a corporate income tax.

Sources: *Significant Features of Fiscal Federalism, Vol. I: Budget Process and Tax Systems*, 1992 (M-180). U.S. Government Printing Office, 1992. *State Tax Reporter*, Commerce Clearing House. *Local Government Tax Authority and Use*, National League of Cities, 1987. *A Revenue Guide for Local Government*: International City Management Association, 1989.

These efforts in Michigan, New Hampshire, and Washington reflect attempts to garner some of the benefits that revenue diversification and balance can bestow—including improved revenue stability and the equitable taxation of many sorts of business activity—while still attending to state tax traditions. In most instances, however, a state would be better advised to diversify its fiscal system for revenue stability through balance, rather than attempting to adopt a single stable tax amid an otherwise flawed fiscal structure.

Three options for improving the balance of state and local revenue generation systems include: adding or rebalancing broad-based taxes, diversifying taxes at the local level, and moving beyond taxes to raise revenues.

▼ Option 1: Revamp Tax Systems to Add or Rebalance Broad-Based Taxes

Rebalancing a jurisdiction's reliance on its major, broad-based taxes can be accomplished by adding a new tax in states or localities that do not levy all of the traditional broad-based taxes, or by restructuring the taxes in jurisdictions where all of the major taxes are currently in use. Adding a new, broad-based tax can be an attractive option for states and localities that are having difficulty financing public services. Naturally, in these instances, revenue prospects would be increased dramatically by adopting the omitted tax. By improving balance in the tax system, the jurisdiction could also see advantages of improved revenue stability, fairness, and efficiency.

Restructuring the tax system by diversifying or rebalancing is not simple, however, nor is it easy. There are deep traditional, political, competitive, and cultural reasons why tax structures have evolved the way they have in various states and localities across the nation. Connecticut and Michigan provide two recent examples of major restructuring.

WHAT DIVERSIFICATION MEANS FOR CONNECTICUT

Less heavy dependence on the sales tax (51 percent of tax revenue before reform; 36 percent after)

A more balanced share of tax revenue from the income tax (11 percent before reform; 34 percent after)

A better environment for economic development

A more stable flow of state revenue for financing public services, including education and other children's services

Source: Oskar Ragnar Harmon and Rajiv Mallick, "An Economic Assessment of Connecticut's Recent State Tax Reform," *State Tax Notes*, August 2, 1993.

▼ *Connecticut: Adding a Broad Individual Income Tax*

Until the early 1990s Connecticut was one of ten states without a broad individual income tax. While the population was among the most affluent in the nation, the state government and local jurisdictions in the state faced continuing fiscal problems.

The state levied only a narrow "unearned" personal income tax that was applied to interest, dividends, and capital gains. It compensated for its low reliance on income taxes by levying the nation's highest statutory tax rates on sales (8 percent) and on corporate income (13.8 percent). This made the state's tax climate unattractive for business development. It also made it difficult to ensure stable funding for vital state functions such as education, since the tax base was especially sensitive to changes in economic activity.[16]

In 1991, Connecticut diversified and restructured its tax base. It undertook the following actions:

- *A broad individual income tax replaced the narrow "unearned" income tax.* The new tax rate was set at a flat rate of 4.5 percent. The tax included personal exemptions and a credit that diminished as income rose.
- *The sales tax rate was reduced* from 8 to 6 percent.
- *The sales tax base was broadened* to include a number of services: motor vehicle repairs, tax preparation services, amusements and recreation, paving, house painting, wallpapering, roofing, siding, sheet-metal working, motor vehicle parking, "900" number phone calls, international phone calls, extended warranties, and use of boat slips.
- *Sales tax exemptions were reduced.* The new sales tax base exempted fewer clothing purchases and included more of the purchase price of used car sales.
- *A two-year phase-out of the corporate income tax surcharge* from its previous level of 20 percent began.

▼ *Michigan: Reducing the Role of Local Property Tax in Financing Education*

Over the past twenty years, many states reduced their historical reliance on local property taxes for school finance. Michigan, where the local property tax yielded two-thirds of school revenue, remained an exception.

WHAT DIVERSIFICATION MEANS FOR MICHIGAN SCHOOL FINANCING

The state share of revenue raised for schools will more than double.

Expenditure differences among districts will narrow.

Local property tax rate differences will diminish.

Reliance on local property taxes to financing education is dropping. Before the changes, in FY 1993-94, local property taxes yielded about two-thirds of school revenue. For FY 1994-95, the first year under the new system, local property taxes yielded about 25 percent and the state property tax produced about 7 percent of school revenue.

Source: Ronald C. Fisher and Robert W. Wassmer, "Centralizing Educational Responsibility in Michigan and Other States: New Constraints on States and Localities," *National Tax Journal*, 48 (September 1995), p. 423.

By the early 1990s, Michigan's heavy reliance on local property taxes to pay for schools produced three distinct and serious concerns. First, the property tax base was not distributed uniformly across school districts, so some districts were rich and others were poor.* Second, there was public displeasure and tenuous support for property tax finance, as evidenced by ten different property tax cut initiatives that appeared on statewide ballots between 1973 and 1993. Also, there was fear that local property taxes might discourage needed business expansion and damage the state's ongoing, highly successful program of economic development.

These concerns sparked dramatic change in school finances. In 1993, the Michigan legislature abolished local school property taxes, then scheduled a statewide referendum on how to replace the lost money. The new system of school finance approved in 1994 brought about significant changes to the state public finance system.[17] In particular:

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*All local tax bases differ widely from locality to locality. Hence, the concern about unequal resources is broader than a concern about property taxes. Indeed, property taxes are usually more equally distributed across local governments than are either income or sales tax bases.

- *The state sales tax rate was increased* from 4 to 6 percent, with the additional revenue dedicated to schools. The sales tax still makes up only a small portion of the total revenues for schools. However, sales taxes tend to be less stable revenue source than other taxes, particularly property taxes.
- *A statewide property tax on all property was enacted*, along with a narrower local tax on non-homestead property.
- *The tax on cigarettes was increased* by 50 cents per pack.
- *Real estate transfer taxes were imposed* at 4 percent.
- *A state foundation grant formula for education was established* that limits the ability of local school districts to vary their spending from the level set by the state formula. The new aid formula guarantees a new minimum foundation spending level for all districts and legally constrains expenditure growth in high-spending districts.
- *A new system of assessing property was instituted*, featuring capped assessment growth rates and property acquisition values.

▼ Option 2: Diversify Tax Sources at the Local Level

As noted elsewhere in this chapter, property taxes are the single most important source of tax revenue for independent school districts and general-purpose local governments—e.g., towns, townships, municipalities, cities, and boroughs. For example, in fiscal year 1991, property taxes produced 97.4 percent of all school district tax revenue raised within the district.[18] Only in four states—Louisiana, Kentucky, Pennsylvania and South Dakota—do other tax revenues supplement school district property taxes so that the share falls below 98 percent. Many general-purpose local governments also employ taxes other than the property tax.

Localities can diversify their revenues, thereby reducing their dependence on the property tax, by adopting broad-based alternatives such as local sales and income taxes. These revenue sources can generate powerful additional tax resources to finance education and other children's services—sometimes exceeding revenue from property taxation. Local excise taxes applied to purchases of selected goods or services are other potential sources of new revenue, although these narrowly focused taxes do not possess the revenue potential of broad-based taxes. Local revenue diversification can also provide property tax relief and other advantages of a more balanced tax system.

States normally have to explicitly authorize the use of local non-property taxes before they can be imposed. In addition, localities—both school districts and general-purpose governments—may find it difficult to administer an array of taxes in a high-quality, economical fashion. Often, they find it more productive to jointly administer a new tax in conjunction with the relevant state tax.

It is important to note that local tax diversification does not necessarily produce greater tax equity. Where diversification to local sales or income taxes has been tried by local school districts, for example, these tax bases tend to display as much disparity across jurisdictions as the property tax. This is particularly true where school districts are small. In a few instances, the distribution of a new tax base can counteract unevenness in the property tax base, but, in general, the equalizing potential is small.[19]

Localities may want to consider the following three options to diversify their tax bases.

▼ *Establish Local Sales Taxes*

In 1994, general-purpose local governments in 33 states levied general sales taxes. Most of these governments piggybacked on the state sales tax to better coordinate taxation procedures and reduce collection costs. Although piggybacking still results in tax rates that can vary at jurisdictional boundaries, vendors and customers avoid the confusion of different tax bases in doing business across city or county lines.

If localities are given the option of administering their sales taxes locally, they should be aware of several problems and inefficiencies that are more apt to occur. Local administration duplicates administrative efforts, complicates compliance by vendors, creates problems when purchases are made in one jurisdiction and delivered in another, and almost certainly reduces the quality of local tax enforcement.[20] Sales taxes levied by general-purpose governments are locally administered in seven states.

Education is supported by local sales taxes in a small number of states. Local school districts raise sales taxes directly in Louisiana and South Dakota. In fact, Louisiana schools raise more revenue from sales taxes than from property taxes. Florida also authorizes school districts to levy sales taxes, but a referendum requirement has been a barrier to adoption of the tax.

In New York, school districts may receive local sales tax revenue from taxes levied by the county. Seven New York counties (Erie, Livingston, Monroe, Onondaga, Orleans, Wayne, and Westchester) levy a local retail sales/use tax—a defined portion of which is distributed to school districts according to average daily attendance or enrollment of pupils residing in the county. Some larger city districts receive as much as 30 percent of tax revenue from that source.

▼ *Levy Local Income Taxes*

Local income taxes are levied by general-purpose governments in 13 states and by school districts in four states (Iowa, Kentucky, Ohio, and Pennsylvania). Local income taxes are usually locally administered and are often limited to employee earnings (payroll) and profits made by unincorporated businesses.

Omitting other types of income narrows the local tax base. But localities would typically find it quite difficult to enforce a broader tax without assistance from the state. In general, income taxes yield far less revenue for localities than do general sales taxes. The gap, however, is closing with the passage of time, particularly in the largest cities.[21]

Of the four states in which school districts impose local income taxes, these taxes are most important as a revenue source in Kentucky and Pennsylvania. In these states, school districts administer their taxes locally, and the base is generally limited to payrolls. Ohio, however, takes a different approach to administration of local school income taxes: not quite 20 percent of the school districts "piggyback" on the state income tax, with local income tax supplements at rates that range from 0.5 percent to 1.75 percent. By using this approach, these Ohio school districts are broadening their local tax base and distributing the tax burden more equitably across resident families (see discussion on broadening tax bases earlier in this chapter).

▼ *Impose Other Local Taxes*

General-purpose local governments levy a wide variety of selective taxes—sometimes closely tied to comparable state taxes. Of these strategies, taxes on public utilities are perhaps the most productive and widespread. However, the yield from this type of local selective tax falls far below that obtained from broad-based taxes. Transient lodging taxes, such as those imposed on hotel and motel receipts, can be productive for certain localities.

A number of states permit school districts to levy miscellaneous taxes, but few are of revenue consequence. Districts in New York, Kentucky, and Nevada levy utility taxes, for example.

Utility and lodging taxes are often administered locally. Given the specialized nature of firms selling these services, state administration is not always necessary for enforcement of reasonable quality.

▼ Option 3: Move Beyond Taxation To Raise Revenues

States and localities traditionally rely on taxation as the primary tool to raise revenue. Although there may be public complaint and confrontation about taxation, when tax systems are efficiently constructed they provide a valuable source of revenue for funding those services best performed by the public sector.

However, as demands for public services continue to rise and resources grow more scarce, governments should consider whether and when alternative forms of revenue-raising are appropriate to finance the services they provide. The two strategies discussed below have implications for financing a variety of public services, including children's services, in some cases.

▼ *Charge Fees for Services*

Governments can assess fees and charges on individuals and businesses when they sell services—such as the provision of water or other utilities—to those recipients. They can also levy benefit fees on those who receive a direct return from certain services—such as police or fire protection in a particular neighborhood—in order to divide the burden of funding those services.

Charging fees for public services works when the purchaser, not society as a whole, is the primary beneficiary of the service. For example, water and sewer service, solid-waste collection, toll roads, bridges, and other transportation facilities, parks, recreation and cultural activities are good candidates for user fee finance because they meet this criterion fairly well. In general, the greater the share of benefits going to primary beneficiaries, the better the rationale for user fees. The greater the share of benefits that go to indirect beneficiaries, the better the rationale for financing the service through general taxation.

What are the potential uses and implications of user fees for financing education, health, and other children's services? In general, the beneficiaries of the services provided to children go well beyond the identifiable children and families actually receiving services. The benefits of today's investments in children will be shared widely in tomorrow's educated, civilized, well-adjusted adults. Thus, there would appear to be little justification in charging the immediate user for these services. In addition, many non-education services to children and their families are primarily targeted to improving the well-being of low-income families, so charging for these services would be inequitable as well as self-defeating.

Nevertheless, user fees can play a useful role in directly financing education and other children's services when they are limited to appropriate circumstances. In the area of education, for example, many communities rely on user fees to pay for certain co-curricular or supplemental services such as driver education that they consider "nice but not necessary." Many also consider it appropriate to charge rental fees for such school items as special books, equipment, musical instruments, and band uniforms. For example, some schools are now starting to rent computers and software for educational use in the home. In the non-education arena, some governments charge fees for family services such as parenting classes and family counseling.

User fees can play a useful role in directly financing education and other children's services when they are limited to appropriate circumstances.

Where fees are charged for children's and family services, consideration should be given to incorporating provisions such as reduced charges or sliding-scale fees to allow equal access by economically disadvantaged families. However, the problems of low-income families in paying fees should not be the excuse for giving free, expensive services to those of greater affluence where the application of user fees is warranted.

The use of fees and charges in the public sector generally has broader implications for financing education, health, and other children's services. To the extent that the costs of services provided by governments can be funded through user fees, this strategy of charging for services "frees up" tax money for spending on such general public functions as education and other children's services, and lessens the pressure on the public tax dollar generally. (See the earlier discussion in this chapter about charging true user prices for services.) For example, some communities in California levy fees on developers of new subdivisions that are used to finance new infrastructure requirements, including schools, that would otherwise have to be financed out of general tax dollars.

▼ *Generate Gaming Revenue*

Many states are experimenting with lotteries and other forms of public gaming to raise revenue. Thirty-six states run lotteries, ten permit casino gambling, and several others host casinos operated by Indian tribes under federal authority.

Casino operations may contribute to the host economies, but profits to the state are seldom great. To the extent that states benefit from such operations, it is usually more from the combined impact of income, property, and sales taxes associated with casino citing and operations than from the gaming profits themselves.

In the case of lotteries, states own them, so the states get the receipts. Here again, however, profits are seldom enough to dramatically change a state's fiscal condition. For instance, in no state do lottery profits currently contribute more than 6 percent of total state tax revenue. Most often the boon is about 2 percent or less.

A number of states dedicate a share of lottery profits to financing general public education. Gaming profits are also used in some states for specific education purposes, such as installing computers and other telecommunications technologies. These revenues, however, often replace other money that had been allocated to public schools. (See the discussion of earmarking in Chapter 3.) States are learning that publicly sponsored gaming is not likely to provide significant new net revenues for education and other children's services.

STRATEGY 4: PRESERVE TAX REVENUES BY BETTER TARGETING TAX RELIEF

State and local governments often use tax relief as a tool to accomplish policy priorities, including adjusting tax burdens for low-income families and other classes of taxpayers. Yet the result is a sacrifice in revenue, because tax relief provisions discharge individuals and businesses of taxes otherwise owed. Tax relief takes many forms, including exemptions, deductions, and/or credits inserted into property, sales, and individual income tax systems.

The impact of tax relief on government revenue hinges on several critical factors. First, it depends upon the generosity of the relief awarded, as well as the number of taxpayers to whom it is extended. In addition, it is affected by the extent to which prevailing tax rates rise to compensate for bases made smaller by relief provisions. Very broad tax relief may require such high tax rates that actual tax reductions may be modest for the intended recipients of relief.

In order to preserve revenue yield, tax relief needs to be allocated efficiently. Experience shows that revenue can be protected and relief maintained—but only if tax relief is carefully targeted. The best way to offer relief is to make sure it is limited to the most deserving and not widely distributed as "tax welfare" to the relatively affluent.

▼ Option 1: Tie Property Tax Relief to Income

Most property tax relief granted to individuals is not targeted. Instead, the relief is granted to all individuals in the jurisdiction or to all individuals in a demographic class, without regard for the economic circumstances of recipients. Property tax relief could be delivered more efficiently if it were targeted only on those with the least ability to pay such taxes.

States use several mechanisms to grant non-targeted property tax relief to individuals:

- *Homestead Exemptions and Credits.* Homestead exemptions remove all or a portion of the value of homestead property from the tax base; homestead credits provide a direct reduction in the tax bill. Most states limit such homesteading tax relief to senior citizens, and other states provide additional relief to military veterans or other classes of taxpayers, but these limitations are not made on the basis of income.[22] Homestead exemptions often involve revenue loss for local jurisdictions because they reduce the local tax base without state compensation; the revenue loss from credits is usually felt at the state level because the state finances the credit.
- *Property Classification.* Under this approach, states levy lower effective tax rates on certain types of property, rather than certain types of taxpayers. Designated classes of property receive either lower assessment levels or lower tax rates than other property. Typically, agricultural and homestead properties are favored; industrial and utility properties are not; and commercial properties are taxed at a level somewhere in-between. Although classification can be seen as an attempt to keep property tax burdens in line with some measure of taxpaying capacity linked to the property itself, there is no scientific standard for assigning rates. In addition, this form of indirect tax relief creates inequities among taxpayers and inefficiencies due to higher tax rates and incentives for taxpayer manipulations.[23]

- *Limitations on Property Reassessment.* This strategy—which California adopted in 1978 as part of Proposition 13, and which Florida and Michigan have more recently enacted—is used to slow the rapid escalation of tax burdens placed on certain or all types of property.[24] Typically, only modest annual assessment valuation increases, perhaps 2 percent or less, are permitted; however, when property is sold, its assessed value is fully adjusted. If limitations on assessment increases are not accompanied by limitations on tax rate increases, this approach may not necessarily provide tax relief. If tax rates are also controlled, however, the revenue loss to governments relying on the property tax can be significant. These systems also guarantee considerable inequities among taxpayers according to how recently their property has been sold.

A more economical approach to providing property tax relief is the "circuit-breaker." This mechanism links the amount of property tax owed to the taxpayer's income. This means-tested relief strategy not only helps economically strapped families with their property tax load, it avoids distributing tax relief to all without regard for their economic circumstances.

"CIRCUIT-BREAKER" PROPERTY TAX RELIEF IN MONTANA

The Problem

Since property tax bills are not directly linked to household income, families can face real financial stress if income earners lose jobs, retire, experience business difficulties, or otherwise encounter property tax bills out of proportion to their current income. The property tax bills continue, even as the capacity to pay them from family income is diminished.

Families caught in this situation have several unattractive options. Do they struggle to meet the property tax bills until their incomes recover? Do they become delinquent on tax obligations and battle the authorities until they are foreclosed? Do they give up their homes and move to a new property?

A Targeted Tax Relief Strategy

Montana employs a strategy that attacks the problem directly. Under the experimental circuit-breaker program adopted by Montana in 1996 (WS 39-3-401), families can qualify for a refund of property tax paid on their principal residence if their income, adjusted for family size and the cost of living in their county, drops below 180 percent of the federal poverty line. For 1998, the relief scheme is as follows:

If Household Income is:	The Property Tax Refund is the Lesser of:
At or below 100% of poverty	$500 or 50% of property tax
100 to 120% of poverty	$400 or 40% of property tax
120 to 140% of poverty	$300 or 30% of property tax
140 to 160% of poverty	$200 or 20% of property tax
160 to 180% of poverty	$100 or 10% of property tax
Above 180% of poverty	No refund

Any refund is reduced by the amount of property tax saved under the state's veteran exemption, homeowner credit, or property tax deferral provisions.

States with circuit-breakers set standards for the amount of current income that can be taken by the property tax, and relieve some or all of the tax "overload" for those who qualify. In most states that use circuit-breakers, eligibility is limited to senior citizens, but a number of states extend eligibility to all families or families with children. Applicants must submit documentation such as property tax bills and income statements; income is typically defined to include retirement income excluded from state income tax.

While circuit-breakers are typically state-funded, thus resulting in some revenue loss to state governments, they are nevertheless a much more efficient mechanism than non-targeted strategies for delivering property tax relief to those who most need it.

▼ Option 2: Expand the Income Tax Base While Targeting Relief

States often provide income tax relief through various exemptions, deductions, and credits that reduce the tax base. As discussed earlier in the chapter, many of these provisions are the result of incorporating federal income tax definitions and provisions into state income tax systems.

Expanding the income tax base by including items not subject to federal taxation generally exceeds the administrative capacity of state tax departments. A more practical and productive alternative is to restructure and narrow income tax relief so that it targets low-income individuals and families. The following two options are not mutually exclusive.

▼ *Increase the State Income Tax Threshold*

The income tax threshold is the amount a family can earn before owing any state income tax. States can target income tax relief on low-income families by increasing personal and dependent exemptions, by increasing the standard deduction, and by enacting earned income tax credits.[25] Raising the income tax threshold relieves families with the lowest incomes from state income tax, and also encourages those at the margin of the economy to enter or rejoin the workforce.

▼ *Limit State Income Tax Relief Available to Higher-Income Households*

States can capture more revenue by shifting income tax relief away from higher-income households and making such relief available only to those less able to bear the cost of government. This can be accomplished, for example, by phasing out personal exemptions and standard and itemized deductions, such as the property tax deduction, at higher-income levels. Another possibility that could be considered is placing higher-income households in higher tax brackets. These revisions broaden the effective income tax base and allow additional revenue to be collected without changing statutory tax rates.

▼ Option 3: Use Sales Tax Credits Rather than Exemptions

States that rely on sales taxes to raise revenue often try to combat the typically regressive nature of sales taxation by exempting a number of commodities on which

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STRATEGY 4: PRESERVE TAX REVENUES BY BETTER TARGETING TAX RELIEF

low-income households typically spend a larger share of their income than do the more affluent (see earlier discussion in this chapter). Among such exemptions, the failure to tax food purchases is particularly costly, both because food makes up such a large portion of total retail sales, and because the exemption is offered without regard to need.

A few states take a more targeted, economical approach to providing sales tax relief. They tax food purchases by all, but then distribute fully refundable tax credits to taxpayers that roughly reflect the tax that would be paid by low-income households. The credit is offered though the income tax, although it is also available to those owing no income tax.

The use of a food tax credit in place of an exemption reduces the revenue loss needed to provide a given level of relief to low-income families. This strategy also improves the stability of sales tax revenue by keeping food purchases in the sales tax base, and allows tourist-destination states to capture a greater share of governmental costs from non-residents.[26] But it may not be as effective in providing relief to the target population. In Kansas, for example, as many as 66 percent of those estimated to be eligible simply do not file for the relief.[27]

SUMMARY

A number of factors significantly affect the ability of governments at all levels to raise public revenue for children. Of overwhelming importance is the sheer size and complexity of the job. Although programs for children and families currently dominate state and local government spending, growth of state and local government resources has not kept pace with the numbers of children in the United States. Brutal competition often exists among rival interests for increasingly scarce public dollars. And raising revenue now is simply harder, because economic, social, and political conditions have changed more rapidly than government tax systems.

Policymakers and advocates for children should explore and be knowledgeable about four broad directions that reformers are taking to modernize public revenue systems. These strategies have significant potential impacts on financing education and other services to children. They are: (1) broadening existing tax bases, (2) aligning taxes with new economic and demographic realities, (3) diversifying and balancing tax systems, and (4) preserving yield by better targeting tax relief.

These are four powerful directions, that considered together or separately, produce a wealth of opportunities to increase revenue yield. They should be considered as guidelines to shape reform strategies.

What can we expect from serious application of these strategies? Finance system upgrades that produce revenue more productively, equitably, and efficiently, and with less harm to citizens and their communities.

In terms of the first broad reform direction, states and localities are working on initiatives that bring the size of sales, income, and/or property tax bases closer to matching the ideal. The critical issue is not the absolute size of tax bases, but the extent of economic activity covered. States should be concerned with expanding their general sales and individual income tax bases, since these taxes generate about half the general revenue raised by states. Local governments should focus on improving the yield from property taxes, since this tax base is the most substantial source of financing public services at the local level.

State and local governments must also align their tax structures with new economic and demographic realities. Many states are considering ways of expanding their sales tax collections on interstate transactions. Burned by past revenue losses, some state and local governments are recalculating the net effects of using tax abatements to stimulate business expansion, and then retooling their economic development strategies. Multistate and multinational businesses present complex tax issues that states are seeking to resolve, in addition to ensuring that new and changing industries bear their appropriate share of the cost of government. And as patterns of property tax shift, state and local governments must also be attuned to keeping property assessments current with actual market values.

With respect to building more robust revenue systems, experience shows that abnormal reliance on any one revenue source, usually accompanied by high effective tax rates, can actually accentuate problems in raising public dollars. High rates place extraordinary tax burdens on certain people and businesses, create economic distortions, and make tax evasion and avoidance appear attractive.

States are generally better off with more balanced revenue systems. Michigan and Connecticut are states in which public leaders have taken on and succeeded in the difficult challenge of revamping statewide general tax systems to make them more balanced and productive.

School districts and other local governments are also seeing the advantages of diversifying their revenue sources. Adopting broad-based alternatives to property taxes, as many have done, reduces their reliance on a single tax base. As we have also learned, however, diversifying local tax bases does not necessarily produce tax equity.

Some states and localities have moved beyond taxation to raise needed revenues. In levying fees and generating gaming revenues, however, policymakers should be aware of their pitfalls as well as their possibilities.

In terms of the fourth strategy for reforming revenue systems, states and localities can do a better job of preserving tax yield by more accurately targeting tax relief, which in the form of exemptions, deductions, and credits effectively lowers the tax burden of individuals and businesses. Governments have given away significant amounts of revenue through multiple forms of tax relief. To preserve revenues governments need to limit relief to the most needy and forgo the temptation to widely distribute tax advantages to relatively affluent taxpayers.

Since governments are unique, each with a singular set of needs and conditions, there are no recipes for universal success in raising public dollars more equitably and efficiently and with little damaging fallout. What works well to raise revenue in one jurisdiction may be inappropriate, undesirable, or infeasible in another. Nor is more money automatically going to mean more and better services to children and their families. Advocates still must make strong cases for their share, and monies must be used wisely to accomplish their intended results.

NOTES

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2 Public Law 104 - 95, January 10, 1996.

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9 John H. Bowman and John L. Mikesell, "Improving Administration of the Property Tax: A Review of Prescriptions and Their Impacts," *Public Budgeting and Financial Management*, 2, Number 2, 1990, pp. 156-165. Evidence also indicates that assessment uniformity is higher where property taxes are high.

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Citizens for Tax Justice, 1311 L Street, NW, Washington, DC 20005, (202) 626-3780.

Corporation for Enterprise Development, 777 N. Capitol Street, NE, Suite 410, Washington, DC 20002, (202) 408-9788.

Federation of Tax Administrators, 444 N. Capitol Street, NW, Suite 348, Washington, DC 20001, (202) 624-5891.

International Association of Assessing Officials, 130 East Randoph Street, Suite 850, Chicago, IL 60601, (312) 819-6120.

Lincoln Institute of Land Policy, 113 Brattle Street, Cambridge, MA 02138-3400, (617) 661-7235.

Multistate Tax Commission, 444 N. Capitol Street, NW, Suite 425, Washington, DC 20001, (202) 624-8699.

National Association of State Budget Officers, 400 N. Capitol Street, NW, Hall of the States, Suite 299, Washington, DC 20001-1511, (202) 624-5382.

National Conference of State Legislatures, Fiscal Affairs Division, 1560 Broadway, Suite 700, Denver, CO 80202, (303) 830-2200.

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Indiana Department of Commerce, 1 N. Capitol Street, Suite 700, Indianapolis, IN 46204, (312) 232-8894

Princeton Chamber of Commerce, 202 East Broadway, Princeton, IN 47670, (812) 385-2134

BACKGROUND: BETTER BUDGETING MEANS BETTER GOVERNMENT 57

Fiscal constraints, desires for better information, and other changes prompt states and communities to improve their budget systems.

STRATEGY 1: STRENGTHEN TRADITIONAL BUDGETING 58

This section reviews ways to make the traditional budget process work better for children and their families by expanding the amount and quality of budgeting information and taking steps to ensure the adequacy of funding, using such approaches as earmarking or "rainy-day" funds.

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CHAPTER 3: BUDGETING BETTER

BACKGROUND: BETTER BUDGETING MEANS BETTER GOVERNMENT

Government speaks its mind through budgeting. A well-constructed public budget document can explain volumes—highlighting costs, establishing priorities, relaying plans, defining limits. Whatever the campaign rhetoric or press conference topic, the enacted budget of a state or community outlines its intrinsic goals, objectives, and priorities across multiple policies and programs. As such, it embodies any compromises made between community leaders on the community's relative priorities.

Budgeting plays a pivotal role at all levels of government, linking revenue estimates to programmatic spending. In fact, budgeting often is thought of as government's most powerful tool for making and carrying out public decisions. Budgets are used to:

- *Allocate available resources* among competing programs and priorities;
- *Plan programs and services*, including serving as a blueprint for policy changes across various agencies and departments;
- *Establish priorities* and spending patterns;
- *Manage government operations* by monitoring how much money is expended to accomplish desired results; and
- *Inform the public* how its money is being spent.

Basic Steps In Public Budgeting

At first glance, public budgeting may appear to vary considerably from state to state and among local jurisdictions—in terms of when the fiscal year starts and ends, how frequently a budget is passed, the kinds of budgetary information that are available to decisionmakers, and the process for public review and comment.

OVERVIEW

Chapter 3, *Budgeting Better*, reviews the traditional budget process and explores ways to modify or overhaul it in order to fund high-quality programs for children and their families. The chapter begins by outlining the pressures on the current budgeting system, such as the failure to focus on program effectiveness in a time of soaring entitlement costs, rising school enrollments, tax and expenditure limitations, and reductions in federal and state aid. As possible responses to these pressures, the chapter discusses how advocates for children and families can become involved in the budget process, the advantages and disadvantages of earmarked funds, and ways to create "children's budgets" that identify the amount and the type of resources that support programs for children and their families. The chapter also highlights the importance of tax expenditures, contingency and "rainy-day funds," and initiatives to create performance budgets that link expenditures to achieving important results for children and their families.

Despite these and other differences, the basics of public budgeting are remarkably similar across the United States. The budget proposal—usually prepared under the aegis of a governor, mayor, county executive, chief state school officer, or other executive official—spells out revenue estimates and spending priorities. It lays out the administration's general policy direction and program preferences. If the budget-setting process is fairly open, the proposal may also reflect the thinking of the various groups whom the budget affects: service providers, special interest groups, and the general public.

Then the proposal is reviewed, considered, and usually amended by the appropriate public decisionmaking body, such as the state legislature, city council, or local school board. The final budget must be approved by this body before it can be enacted. In its deliberation on the proposal, the policymaking body may gather information through hearings and further research to inform its decisionmaking.

New Thinking About Budgeting: Two Reform Directions

State and local policymakers, including those interested in supporting quality education and other children's services, are pursuing two approaches for improving the ways in which public funds are budgeted. These efforts are taking two important directions: *strengthening traditional budgeting* and *focusing budgeting decisions on performance.*

TRENDS PROMPTING PUBLIC BUDGETING REFORMS

Continuing Desires for New and Better Budgeting Information

- Persistent dissatisfaction with traditional budgeting methods.
- Conventional budgeting projects expected line-item costs—salaries, benefits, or supplies—and not much about program effectiveness.
- Tough budget choices require more and different information to allocate scarce resources among programs with differing objectives.

States and Localities Face Increasing Fiscal Pressures

- Tightened fiscal constraints and increasing service demands require more efficient and effective programs. Court decrees, entitlements, debt service costs, and pension funding requirements create financial burdens and limit funds available for other purposes.
- Tax and expenditure limitations in some jurisdictions are forcing governors, legislators, and city and county executives to closely scrutinize revenue sources, spending patterns, and priorities.
- Reduced federal and state aid means that states and localities must critically re-examine revenue sources and spending patterns.

Rapid Technological Changes Can Help Governments Budget Better

- High-tech budgeting tools are less costly and more widely available to states and localities.
- Electronic systems process information more quickly and accurately, thereby helping leaders make better policy and program decisions.
- Improved accounting, evaluation, computing, and database storage capacities permit better fiscal decisionmaking—how much and in what manner allocated dollars should be spent.

STRATEGY 1: STRENGTHEN TRADITIONAL BUDGETING

Many states and communities are improving the way they build and enact their budgets. They are upgrading the conventional budgeting processes that they have used in the past—improving ways in which the executive and the majority of an elected decisionmaking body, be it a local school board or state legislature, come to consensus on which programs or services should be supported and to what degree.

This section of the chapter highlights five basic approaches to strengthening traditional budgeting processes. The first four improve upon the knowledge available to decisionmakers and others. The fifth provides an approach that many states and localities are using to better handle fiscal uncertainties, such as unexpected revenue shortfalls or unanticipated expenditure demands.

▼ Option 1: Open the Budgetary Process

Many individuals and groups have a vested interest in government budget decisions. Much has been written about the influence of corporate lobbyists and other powerful groups in determining spending priorities or receiving preferential tax treatment at the federal, state, and local levels. Parents and others concerned about the well-being of children also have a vested interest in the budget process.

In a given state, children's programs may vie for public funds in competition with other public- and private-sector entities, including powerful groups such as corporations looking for preferential tax treatment and economic development assistance. The rivalry, often without benefit of a level playing field, is for increasingly limited funding. Thus, it is critical that child advocates and others interested in children's services remain informed and stay active in determining budget allocations and priorities.

Furthermore, to improve the budgeting process, community leaders—whether they be elected officials, concerned parents, or child advocates—should encourage greater public understanding of and participation in the allocation of resources. There are a number of approaches that governors, state legislators, county commissioners, school board members, child advocates, and others interested in education and other children's issues should consider. Depending on local conditions, some of these options can be undertaken by government officials, while individuals outside government might be more effective in improving existing budgeting processes, even those internal to government, in other areas.

It is critical that child advocates and others interested in children's services remain informed and stay active in determining budget allocations and priorities.

▼ *Make Government Budgetary Highlights More Readily Available*

Several types of budgetary or fiscal information are critical inputs for those attempting to influence budget decisions, and can be made readily available to a variety of audiences. For example, *budget summaries* condense detailed budget information. They highlight fiscal priorities and outline key patterns and trends in revenues and expenditures, such as the percentage of the budget that expenditures for education consume and whether this percentage is growing or declining. *Fiscal impact studies* report the monetary effects of proposed programmatic changes and are typically prepared throughout a government's legislative session.

▼ *Include More Government Decisionmakers in the Budget Process*

As noted earlier, budget processes vary considerably by state and locality. For example, in some jurisdictions, only top executive branch officials become involved in building budget proposals. Little, if any, input is solicited from front-line supervisors and workers, who may know best about program operation issues that should be considered.

In some states, budget decisions are reached primarily in budget or finance committee deliberations, with relatively few legislators participating in the process. At first glance, this approach appears to have an advantage; it looks efficient because it limits debate. However, allowing only a handful of legislators to make tough tradeoffs—for example, between decreasing taxes or funding community-based family service programs—can result in spending patterns that do not reflect the true priorities of that community.

The possible advantages of expedient decisionmaking must be weighed against the benefits of involving others, who represent more and different constituencies, in the decision process.

▼ *Encourage Fuller Participation in Budgetary Matters*

Engaging the public in the process of government budgeting can help decisionmakers gain a fuller appreciation of a range of relevant viewpoints and information. It can also help decisionmakers make choices that better reflect the public will. States and communities can employ a variety of mechanisms to open the budget process to the public, yielding many benefits, including new ideas, feedback, and buy-in. Some strategies, such as holding open hearings or public budget meetings, encourage public input and dialogue use between decisionmakers and those affected by the decisions—e.g., taxpayers, service providers, and service recipients. Other approaches, such as *truth-in-taxation provisions* and *electronic posting of budgetary information* on the World Wide Web, focus on improving the communication of budgetary information to all stakeholders.

▼ *Consider External Budget Analyses*

Those interested in influencing the financing of education and other services for children have found value in considering the results of independent budgetary analyses performed by individuals and organizations external to government.

Externally produced budget analyses serve important functions. They produce a useful, independent check of the relative strengths and weaknesses of a government-built budget proposal. They also often offer alternative financing proposals for decisionmakers to consider. When focused on a particular set of issues or related government programs—such as public expenditures for children, or on K-12 education—they often encourage discussion on how to improve the services provided.

Many state advocacy organizations, for example, produce documents analyzing a governor's annual state budget proposal. The National Association of State Budget Officers, in collaboration with the National Governors' Association, also produces an external analysis—an annual analysis of the federal budget. This document helps guide deliberations of the nation's governors on how to best respond to proposed federal spending changes.

▼ *Intervene at Key Points in the Budget Process*

A more open and inclusive budget process should promote better decisions about programs important to children and their families. Advocates for children and families and other concerned citizens should intervene in the budget process at key points to take advantage of the opportunities afforded by an open and inclusive system. These decision points include hearings during the regular legislative session, as well as presession hearings by state and local budget offices and legislative subcommittees.

Because incremental budgeting—making minor modifications to prior spending patterns—is so common, reformers should keep in mind the limitations created by prior commitments to finance schools, health care, public safety, and public works. Proposals that can be financed while respecting or reinforcing those commitments may have greater chances of success. Many finance reform initiatives

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targeted at children and their families have also benefited from the creation of linkages to other public priorities and initiatives, such as economic development.

Once they have tailored their proposal to reflect economic, social, and political realities and constraints, reformers must identify key individuals or institutions that could advance—or block—their budget proposals. Which individual or agency in the executive branch has taken leadership on children's issues? Which legislative leaders have made children a priority when determining budget priorities? Which of the program committees (human services, education, public safety) or subcommittees and which of the "money committees" (budget, finance, appropriations, revenue) or subcommittees are most important or sympathetic to the needs of children? What task forces, commissions, outside reports, or trends could influence the framing of the issues and catalyze action? These are among the questions for reformers to consider as they try to find the important points of leverage that will enable them to change budget allocations to improve education and other children's services. (See Chapter 6: *Building Support for Finance Reform* for more information on strategies to build support for finance reform.)

TABLE 3-1

STATE REVENUES EARMARKED FOR K-12 EDUCATION

State	Sales Taxes	Severance Tax	Sin Taxes	Individual & Corporate Income Taxes	Other Revenue
Alabama	✓		✓	✓	✓
Alaska			✓		
Arizona					✓
Arkansas	✓				
Florida					✓
Idaho			✓		
Illinois	✓		✓	✓	✓
Kansas	✓	✓		✓	
Louisiana		✓			
Michigan	✓		✓		✓
Minnesota		✓			
Mississippi	✓				
Missouri	✓		✓		
Montana		✓		✓	✓
Nebraska		✓			✓
Nevada	✓				✓
New Mexico		✓			
North Carolina				✓	
Oklahoma		✓			✓
Oregon		✓			
South Carolina	✓				
South Dakota	✓				
Tennessee	✓		✓		
Texas	✓	✓	✓		✓
Utah	✓			✓	✓
Virginia	✓				
Washington			✓		✓

Source: Arturo Pérez and Ronald Snell, *Earmarking State Taxes*, Third Edition, Denver, Colorado, April 1996, Table 4 and Center for Government Services, Rutgers University.

▼ Option 2: Earmark Funds

Taxpayers, increasingly frustrated with the ability of their elected officials to allocate funds efficiently, have employed a number of different methods to circumvent traditional budgeting processes. Earmarking is a common method to link revenues to particular governmental activities.

This section discusses earmarking, or tying revenues to expenditures for particular children's services. A government may *dedicate revenues*, or tie a particular revenue to a given program or activity. It may also *guarantee expenditures*, or use a given level or percentage of revenues or expenditures to support particular activities. These approaches are not mutually exclusive.

All states earmark at least some portion of their funds. In FY 1993, approximately one-quarter of state tax revenues were targeted this way, although the prevalence of dedicated revenues as a budgeting tool varied considerably by state. Alabama earmarked the largest percentage of its tax revenue, dedicating nearly 90 percent of its funds. On the other hand, Kentucky only designated 4 percent of its tax revenues to specific purposes. In terms of earmarking for children, in FY 1993 more than half of the states dedicated state taxes to K-12 education, health, welfare, or social services.

▼ *Dedicate Revenues to Education and Other Children's Services*

Twenty-eight states dedicate revenue for education spending. Taxes most frequently designated are sales taxes (14 states), severance tax (9 states), and "sin" taxes on items such as alcohol or tobacco (9 states). Earmarking for education is most prevalent in southern and western states. Just one state in the Mid-Atlantic region earmarks revenue for education. No states in New England have adopted this practice. Table 3-1 summarizes state earmarking practices for education.

Many states also earmark funds for health, welfare and social services. In FY 1993, 27 states earmarked tax revenue from one or more sources for these programs. Of this number, 20 states dedicated funds from cigarette/tobacco taxes or alcohol/liquor taxes.

In New Jersey, employer payroll taxes contribute to a relief fund for children with catastrophic illness. In Pennsylvania, a portion of the cigarette tax is dedicated to a children's health fund. And in Florida, part of the alcoholic beverages tax is designated for child and adolescent substance abuse services. Generally, funds are not earmarked for groups of children by age group, although there are a few exceptions.

CONSIDER THESE FACTORS BEFORE EARMARKING...

Upsides

- Can help ensure that adequate funds are budgeted for children's programs.
- May create more stable funding streams that cushion children's program budgets in austere times.
- Has considerable political coin, buying more public satisfaction than raising taxes to fund certain programs.
- Various revenue sources can be tapped—e.g., direct appropriations; charges for birth, death, and divorce documents; taxpayer donations designated on tax returns; and interest income from trust and other private sources.

Downsides

- Additional funds raised may be offset by reductions from other sources—thereby diminishing or eliminating desired impact.
- Spending floors can become ceilings.
- Can complicate financing—burdensome planning, forecasting, and budgeting practices.
- May confuse the public about government spending.

Recent changes in the way education is financed in Michigan demonstrate the advantages and disadvantages of earmarking. Prior to 1993, Michigan taxpayers had one of the highest property tax burdens in the nation. In 1994, however, Michiganders voted overwhelmingly to rely more on sales taxes and less on property taxes as sources for education funding, earmarking additional sales taxes and other revenue for education.

This referendum was prompted by several actions taken by the state legislature. In July 1993, it voted to eliminate the property tax as a source of revenue for the state's schools. The legislature was constrained, however, in fully replacing the lost revenue through other revenue sources because of constitutional restrictions. To replace these revenues, the legislature partially reinstated the property tax and asked voters to choose between earmarked increases in the sales tax and the income tax.

This desired reform probably would not have been possible without the link to education—the need for replacement revenues to ensure that education would not be severely cut in response to legislative action.

LESSONS LEARNED ABOUT EARMARKING REVENUES: FINANCING MICHIGAN PUBLIC EDUCATION

Earmarking Revenue Often Fails to Adequately Cover the Costs of a Particular Program

In Michigan, revenues earmarked for the School Aid Fund covered only 85 percent of education expenditures; even in the first year, additional sales taxes were earmarked.

Political Assets Can Help Rectify Shortfalls due to Earmarking

Because Michigan views education as a real asset in promoting its economic development and quality of life, a broad base of political support existed to make up the difference between what was anticipated by earmarking and what was generated with earmarked funds.

Earmarking Can Complicate Budgeting Procedures

In Michigan, it required transfering and managing allocations among separate funds, thereby making additional accounting transactions necessary.

CHILDREN'S TRUST FUNDS: MANY RELY ON EARMARKED SERVICES

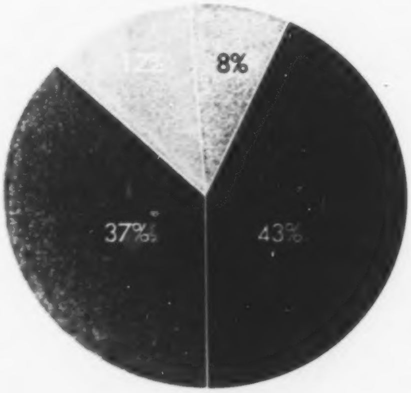
- These legal bodies, similar in nature to private trust funds, act as agents for organizations dedicated to serving children, and account for assets held in trust for the state's children.
- Children's Trust and Prevention Funds exist in all 50 states and the District of Columbia. First established in Kansas in 1980, children's trust funds promote and encourage the development of community-based child abuse prevention efforts.
- Over half the states finance their Children's Trust and Prevention Funds through earmarked funds.

Fifty-seven Percent of the States Earmark Particular Revenue Sources

▼ States that earmark fees and charges on
birth certificates, marriage licenses, or divorce filings.
States that earmark taxpayer donations
collected on state income tax returns.
States that earmark interest income
from a trust fund or private sources.

Forty-three Percent of the States Do Not Earmark Particular Revenue Sources

▼ States that use direct state appropriations.



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▼ Option 3: Create a Children's Budget

Building a thematic children's budget is an excellent approach to understanding what is being spent for a given population or to achieve a certain set of results. The information is as useful inside government as it is for increasing public understanding of government spending. Creating a budget focusing on children can provide a comprehensive examination of all government spending for kids—arraying spending in ways not normally contemplated in ordinary government budgets (for example, across program, department, and agency boundaries).

AN EXEMPLAR: THE CALIFORNIA CHILDREN'S BUDGET

The California Children's Budget highlights both the quantified need for children's services, as well as the state policies and programs that focus on meeting this need.

A comprehensive analysis, the budget analyzes fiscal and program information in numerous areas: poverty alleviation, housing, nutrition, health, special needs, child care, education, child protection, and juvenile justice.

The document contains relevant, timely, and highly readable information on:

- Current conditions
- Need for programs
- Previous years' expenditures
- Proposed funding levels

The Children's Advocacy Institute, a private research and advocacy organization, produces the budget.

The typical children's budget assumes certain levels of projected revenue and focuses primarily on examining the spending side of the budget. Usually a children's budget gathers and presents data on state spending for children and their families, documenting the ability of existing programs to address children's needs.

Consequently, a state children's budget has enormous power to focus public discussion on critical public financing questions such as: What is the appropriate level of spending for public education? For other children's services? Will projected expenditures adequately meet children's needs? Should spending be shifted between different functions or programs to meet changing needs?

Children's budgets are produced in many states. They are the product of organizations internal and external to government. Depending on the state, children's budgets are produced by state agencies, governor's subcabinets, independent organizations, or statewide child advocacy groups.

Child advocates have been instrumental in impelling state and local governments to compile information on spending for children. Many of these initial efforts were written into law. For example, legislation in Kansas requires the state to publish data on "the state's efforts in meeting the needs of children." Oklahoma and Los Angeles County also publish regular children's budgets that provide descriptions of spending for children by function, such as education, child care, and health.

▼ Option 4: Report Tax Expenditures to the Public

State and local policymakers can significantly improve budgeting by regularly reporting tax expenditures. *Tax expenditures* grant preferential tax treatment to certain individuals, households, or corporations. Although no direct outlay of public funds is made, these tax provisions are viewed as similar to direct government expenditures because they reduce government revenue and provide direct benefits to individuals or organizations. Tax expenditures accrue when a government departs from standard tax procedures to accomplish other policy objectives—for example, by reducing the tax base, varying the tax rate, or authorizing non-standard accounting period rules.

Tax expenditures often are ignored during the budget process because they do not constitute a direct outlay of resources. As a result, policymakers and the public may not fully understand the magnitude, effectiveness, or implications of these expenditures. Yet they represent important benefits dispensed by government and should be reviewed and made explicit along with other resource allocations.

Tax expenditures often are ignored during the budget process because they do not constitute a direct outlay of resources. Yet they represent important benefits and should be reviewed along with other resource allocations.

Both states and local governments should consider publishing tax expenditure information. Currently, twenty-one states regularly report tax expenditures and fewer than 50 percent of all local governments—25 percent of cities and 42 percent of counties—report information on abatements to the property tax, the foremost source of local government revenues.

The lessons that have been learned highlight several considerations for states and localities when reporting tax expenditures. State and local leaders, along with taxpaying citizens, should encourage governments to:

- *Estimate the broad range of tax expenditures.* Tax expenditures amass when states provide preferential tax treatment for various types of taxes. Thus, it is important to estimate the impact of these procedures for sales taxes and property taxes, as well as income taxes.
- *Establish reasonable baselines for comparison.* It takes considerable work to establish a reasonable and accepted baseline for comparison—that is, what the cost is to the jurisdiction granting the tax expenditure. This is a critical step in the estimation procedure. Often, this will involve making allowances for administrative or other considerations that make it difficult for states or local governments to tax all possible sources. For example, many states exclude tax expenditures resulting from conformity to the federal income tax and state constitutions.
- *Consider using multiple estimation procedures.* Tax expenditures at the state or local level typically are estimated using only one estimation procedure—calculating foregone revenue—while two methods are used at the federal level. More sophisticated states may choose to get a better handle on the magnitude of these provisions by employing the second technique as well—namely, calculating the equivalent outlay.

▼ Option 5: Build Procedures to Address Unexpected Events

Another approach used to improve traditional budgeting is contingency planning for unexpected budget shortfalls and other unanticipated, unpleasant surprises. These practices are intended to assure effective, appropriate, and timely intervention when needed—so that reduced revenue collections do not interrupt the provision of critical children's services such as education.

Approaches for addressing unexpected events vary considerably, depending on a jurisdiction's financing traditions and on the predictability of its mix of revenue sources. The inherent uncertainty of estimating future revenues has also led some jurisdictions, especially those heavily reliant on highly unpredictable revenue sources, to develop a number of proactive approaches for cushioning revenue shortfall.

STRATEGY 1: STRENGTHEN TRADITIONAL BUDGETING

▼ *Maintain a Small General Fund Balance*

Several states maintain a *general fund balance*—leaving a small fraction of estimated state revenue collections unappropriated. In Delaware, Mississippi, and Rhode Island, for example, only 98 percent of revenue estimates are appropriated. In Oklahoma, where the state receives a large percentage of its funds from sources tied to the relatively volatile energy industry, the state is not permitted to appropriate more than 95 percent of its estimated funds.

▼ *Put Rainy-Day Funds Aside*

Most states have created a *budget stabilization fund*. These funds, often termed "rainy-day funds," help states and localities deal with fiscal crises.

▼ *Make Contingency Decisionmaking Plans*

Other approaches offer solutions to *adjust spending levels and priorities* when revenues are less than expected. Some states have adopted contingency procedures that allow the executive to make necessary cuts; permit an emergency budget to be passed jointly by the executive and the policymaking body (or a small select group of members); and delegate authority during these times to an independent third party. These procedures are especially important when legislative bodies are not in session.

STRATEGY 2: FOCUS BUDGETING ON RESULTS

Many policymakers find that traditional line-item budgeting impedes governing-for-results, which is an approach rapidly finding favor among state and local government leaders who are increasingly called upon to make complex decisions.

Constrained by old and new budgetary choices, such leaders find it increasingly difficult to identify overlapping programs, conflicting priorities and/or wasteful spending. Generally, they discover that results have not been defined or tracked. Seldom are programs expanded or eliminated on the basis of their performance in helping to achieve socially desirable results. Instead, policymakers and the public have struggled to figure out what they actually get for their money.

Attempts to rectify the situation are not new. The landscape is littered with approaches: Planning, Programming, Budgeting Systems; Management by Objectives; Zero-Based Budgeting; and the like. Each has made its contribution to the body of knowledge and practice in public budgeting. None has succeeded in replacing current methods with effective tools to calculate the cost and value of achieving results.

In recent years, some policymakers have begun to shift the budgetary focus away from examining whether program resources are adequate and towards investigating whether they are achieving results. While these approaches appear promising in rationalizing allocation processes to focus on what the public is getting for its money, they are still in their infancy, with little hard evidence on their effectiveness. There are some variations on the theme of results-based budgeting, but these approaches share common principles. Four different variations or options are discussed below that are available to states and localities to move towards a more results-driven budget system. They are: (1) budgeting for results, (2) budgeting by function, (3) budgeting for investment, and (4) using technological advancements to implement results-based budgeting reforms.

▼ Option 1: Budget for Results

Results-oriented budgets are rooted in planning processes that enable decisionmakers to define desired results. Some governments organize their results-oriented planning and budgeting activities by cross-agency functions. Most jurisdictions that use this approach conduct their planning within agencies. Nevertheless, the key in both of these processes is that budgeting and other related tools are vehicles for financing achievement of strategically defined results.

Results refer to the bottom-line conditions of well-being for children, families, or communities. They reflect basic concerns of citizens about how they wish to live. As such, results reflect not only the performance of the government, but also the numerous private actions of individuals, families, communities, and businesses that contribute to social well-being. Results include children born healthy, children ready for school, children succeeding in school, and safe and supportive communities.

SUCCESSFUL RESULTS-BASED BUDGETING IN VIRGINIA AND ARIZONA

	In Virginia...	In Arizona...
Historical Background	Appropriations Act of 1992 authorized pilot development of guidelines for measuring performance of new programs and specific measures for selected existing programs.	Groundbreaking Arizona Budget Reform Act of 1993 linked strategic planning and performance results with the state budgeting process.
Purpose	Focuses statewide planning, performance measurement, and budgeting on results.	Creates governance processes, tools, and standards for a more performance-driven state government.
Approach	Tracks key measures to answer questions in areas such as: ● Input - What resources are to be expended? ● Output - Have desired services been rendered and did they make a difference in people's lives? ● Quality - How well has service been provided? ● Efficiency - What level of effort is needed to achieve desired results? To streamline processes?	Public and private sectors involved in creating and using: ● Master List of State Programs - Used to determine if budget requests will support programs' missions and influence results. ● Managing for Results Handbook - Defines standard planning model for use in all state agencies. ● Program Authorization Review - Used to evaluate state agencies' performance and as the basis for legislative decisions to retain, modify, or eliminate funding for programs.
Unique Lessons	Begin with strategic planning, clarify types of measures to be used, and be sure staff is fully trained on how to define and monitor results.	A successful results-driven system must be rooted in all branches of government, not just the executive.

Once a community has defined desired results, usually through a process that includes broad citizen participation, it must supplement them with *indicators*—measures that reflect and help quantify whether vital results are being achieved. Examples of indicators are rates of full immunization for children ready to start school; reading and math achievement test scores; high school graduation rates; and rates of teen pregnancy and drug use.

Results and indicators are then linked to *performance measures*, the third major element in a results-based budgeting system. A performance measure reflects the effectiveness of agency or program service delivery, and it can be used to assess the performance of public agencies in helping to achieve important results. Typical performance measures address matters of timeliness, cost-effectiveness, and program quality, such as child abuse investigations completed within 24 hours of a report, or the cost of child support enforcement for each dollar collected. Performance measures can inform public officials about whether programs are working, as well as point out where changes in management, program design, and budgets are needed.

While many state and local governments are moving toward this ideal, results-based budgeting for education and human service outcomes is still in its infancy. There are several challenges to address. Results are difficult to quantify using readily available data. To date, public data collection has focused on inputs like numbers of people served, not on what happened as a result of the supports and services they received. Choosing the indicators and performance measures used to track progress in achieving results is a critical part of the results-based budgeting process. In addition, policymakers are still grappling with how to link results-based budgeting to personnel, management information, and accountability systems, and with how to integrate results-based budgets with traditional line-item budgets.

Confronted with these very real challenges, public leaders are moving incrementally toward comprehensive results-based budgeting. State systems developed for use in Arizona, Oregon, and Virginia are leaders in implementing results-based budgeting. Other state, county, and local governments also prepare notable results-based budgets. Among them are Minnesota; Utah; Texas; Charlotte, North Carolina; Indianapolis, Indiana; and Phoenix, Arizona.

Functional performance budgets begin to answer questions of purpose: What do we do? What public purposes are we attempting to serve?

▼ Option 2: Budget by Function

Virginia and Arizona, while both developing results-based budgeting, did not depart from using a line-item format. This allowed them to examine program performance, but not to scrutinize performance of broad functions across programs. However, budget innovators in some states and localities are attempting to analyze how well they spend public dollars in a broader context—by creating functional budgets.

Functional budgets are a variation of performance budgets that array public spending by function rather than by program. They identify government lines-of-business, as it were, that cut across individual programs and departments. These functional performance budgets begin to answer questions of purpose: What do we do? What public purposes are we attempting to serve?

Such budgets reveal the core capacities and/or functions of government. They realign spending categories from organizational to functional spending. For example, they can show how much a city spends on public safety, not just on the police department; or how much a state spends on child health, not just the early childhood immunization program.

Two examples, the state of North Carolina, and the city of Charlotte, North Carolina, illustrate recent state and community efforts to budget by function. In both of these cases, functional budgeting has refocused the attention of leaders, both in and outside of government, on identifying government's most critical priorities. These reviews have prompted a re-examination of all functions, including services for children, and prompted state and community leaders to focus on their relative priorities and the best ways for accomplishing their goals.

▼ *Budget by Program Performance: North Carolina*

A *program/performance budget* (PPB) displays resource/expenditure investments by functional categories or programs that cut across departmental lines. In North Carolina, the process begins with *program planning* that groups activities of state government along functional lines and focuses on outcomes for these activities. Program planning activities are fully integrated into developing a program budget. Another key complementary activity is *department operations planning*, focusing on how results are achieved.

In the 1995-97 budget cycle, North Carolina prepared performance budgets for six program categories: environment; health and safety; justice; corrections; social and economic well-being; and economic development and commerce. Four additional categories—education, general government, cultural affairs, and transportation—are slated for the 1997-99 budget cycle.

Together, these categories reflect the full effort of state government. This attempt to rationalize the budget process and align it with results was one of the streamlining recommendations of North Carolina's Government Performance Audit Committee. The approach enables state decisionmakers to highlight objectives and strategies, eliminate redundancy, identify gaps, support better management, and increase accountability.

North Carolina is phasing in this performance planning and budgeting effort over three biennial budget cycles. In the first two cycles, the budget office is preparing both a traditional line-item and a performance budget. By the third biennial budget, the budget office will only prepare a performance/program budget.

▼ *Change the Way Government Conducts Business: Charlotte, North Carolina*

A functional analysis of a jurisdiction's budget can have far-reaching implications for reforming the basic structure of government. In the case of Charlotte, North Carolina, for example, a functional analysis of city services led to dramatic change in the way the city does business.

When re-examining their city's spending patterns, city leaders asked themselves in 1992: If we were to design the city services anew, what would we create? What services would city government provide? How would they be financed? How would the city organize to deliver services? Their conclusion was that a dramatic change was needed in the organization and culture of city government.

As a result of these deliberations, Charlotte streamlined its operations. It reduced 26 departments to:

- Nine *key mission-focused businesses*: aviation; fire; neighborhood development; planning; police; engineering and property management; solid waste services; transportation; and utilities.

- Four *support businesses* (budget and evaluation; business and support services; finance; and human resources) that help the key businesses accomplish their goals by providing them with core administrative services.

The transition from departments to businesses involved several key changes. Each business is now responsible for preparing an annual *business plan* and a *performance plan*. New business executives had to be selected to run the newly formed businesses. Department heads were encouraged to apply for new jobs as key business executives; those department heads who were not selected received other important jobs with no cut in pay. The government officials selected to head the new key businesses had to be retrained to think of their departments as businesses and, consequently, each participated in a six-month executive training program.

Now in its third year, the benefits of the new functionally driven system are apparent. Charlotte responded to a slowdown in economic growth and tax revenue collection by reducing 683 positions, while introducing a performance measurement system that ties the goals of individual departments to the priorities set by the key businesses and the city council. In turn, employees' annual performance objectives reflect their agencies' annual performance targets. City agencies have exceeded their targets for emergency response time, crime processing, traffic accidents, leveraging of private business investment, job placements for parents on welfare, and other vital services.

▼ Option 3: Budget for Investment

INVESTMENT BUDGETING TO ENCOURAGE SELF-SUFFICIENT FAMILIES: IOWA'S SPEARHEADING EFFORTS

Created by Iowa's legislature in 1993, the Iowa Council on Human Investment is:

- Undertaking the only statewide experiment with investment budgeting;
- Developing a long-term strategy to help families leave or avoid poverty and reconnect with their communities;
- Constructing an investment budget model and methodology to determine the return on investment of various programs to assist these families;
- Testing a new investment model to determine the present net value of outcomes in selected sites throughout the state; and
- Also establishing a relevant performance management system, with long-term goals, outcome-based performance measures, and an outcome-based performance budget.

Some policymakers eager to apply private sector investment thinking to government decisionmaking may consider budgeting for investment as a way of determining relative spending priorities for children and families. It is still in the development stages as a budgeting tool for education and human service programs, but a few states and localities are trying to use ROI (or return on investment) budgeting concepts, models, tools, and strategies for these services.

Investment budgeting permits decisionmakers to make budgeting choices based on the estimated return from investing in different programs or activities. In a sense, investment budgeting builds on performance budgeting, providing decisionmakers with even more information than performance budgets.

In particular, investment budgeting estimates the value of an outcome and calculates the rate of return realized from such an investment, not simply the unit cost of different types of services. State and local leaders trying this approach are moving beyond the investment rhetoric to *actually calculate the return* on public expenditures, or investments; to *compare alternative investments* based upon expected returns; and to *make choices among investments* to produce the greatest "portfolio" yield.

ROI budgeteers are asking questions such as: How many healthy births would a program strategy yield with one level of program effort versus another? How many laid-off workers could be returned to the workforce as a result of one set of strategies versus another? Which programs in the state "portfolio" to alleviate poverty should be eliminated on the basis of poor performance?

While investment budgeting is compelling in its logic, it is virtually untested. Only one state—Iowa—is experimenting with the concept. Iowa's Council on Human Investment, a bipartisan group created by the Iowa Legislature, is working with sites throughout the state to test whether an investment budget will assist policymakers in assessing the potential returns from alternative intervention strategies and making appropriate budgeting decisions.

▼ Option 4: Take Advantage of New Tools and Technologies to Inform Budget Decisions

Those interested in supporting education and other children's services can also take advantage of technological changes to improve budgeting for these programs. New computer-based tools that utilize modern technologies are emerging to help state and local decisionmakers implement results-driven budgeting. These tools are making it faster and easier to process and carry out the complex calculations needed for decision-making—for example, estimating government revenues and expenditures for vital functions such as education or child care. They are also allowing decisionmakers to sort through more program and budgetary data to make more efficient resource allocations.

Advances in the communication sector are also improving the budgetary process, enabling states and local governments to transfer large quantities of information through the Internet or electronic file transfers. These technological improvements have considerably reduced the time needed to assemble the relevant materials needed to compile budgets, which allows budget estimators to provide further valuable detail to decisionmakers.

Numerous groups—including state and local governments, the foundation community, and various national organizations—are availing themselves of the advanced technology to budget better. Two new tools demonstrate well the broad range of information that can enhance and improve the budgeting process through better use of technology.

Decisionmakers can use technology to more easily develop and analyze functional or programmatic budgets. In the education field, a computer-based model called The Financial Analysis Model provides a good example of where the use of technology is helping to accomplish these tasks. The model enables principals, school district officials, school board members, and interested parents and community members to analyze budgetary or financial data at either the district or the school level. It operates on a personal computer and can analyze either budget figures or actual expenditures, allowing school leaders to determine whether the school or district is staying within its budgetary guidelines and developing informed estimates for future budgets.

Developed by Coopers and Lybrand and the U.S. Chamber of Commerce's Center for Workforce Preparation, the computer-based model utilizes modern spreadsheet technology to allow school leaders to analyze spending along multiple dimensions: along *functional* lines (e.g., instruction, instructional support, operations); along *programmatic* lines (e.g., general education, special education, gifted and talented programs, summer school); or among *grade levels* (e.g., elementary, middle, and high schools). One of the chief advantages of the tool is that it provides a powerful tool with relatively little investment; although it employs state-of-the-art software technology, it operates on personal computers, a technology that is widely available.

Other computer-based tools can assist community leaders to make more informed budget decisions by linking budgetary data with other data. One example of just such a tool was designed to help local government leaders develop more performance-based budget and management systems. The interactive multimedia computer training program, *Applying Performance Measurement*, uses current technology to educate government managers and officials about the basics of performance measurement.

The computer program uses CD-ROM technology to allow local governments to have a vast amount of information at their fingertips and to access this information in a simple manner. Developed by the International City Managers Association (ICMA) in partnership with other national organizations, it assists cities and counties in developing their own measurement system, offering detailed suggestions on how to take critical steps, including how to best define results, identify relevant data sources, and make effective comparisons. Like the Financial Analysis Model developed for schools, it allows policymakers to become better informed about budgetary and related matters with relatively little investment by employing state-of-the-art-technology.

SUMMARY

There are ample reasons for strengthening government's potentially powerful voice: its budget. Whatever the level of government, budgeting plays a pivotal role in public decisionmaking—linking revenue estimates to spending, highlighting priorities, relaying plans, and defining limits.

Today, budgeting choices affecting children and families are more difficult and complex than ever. In addition to projecting costs, they require new and better information about children's needs, ongoing programs, and results expected and attained. Having fewer public dollars and more ways to spend them demands closer scrutiny of a jurisdiction's budget: both its revenue sources and its spending patterns and priorities. Fortunately, high-tech budgeting tools are less costly and more available, helping state and local governments make the astute decisions that are needed. Government is able to process needed information more quickly and accurately, which permits better fiscal decisionmaking and management.

There are several important ways in which budgeting innovations are helping policymakers and citizens make today's hard public spending choices.

- Traditional public budgeting reforms are improving upon the knowledge available to people as they make decisions, and equipping them with tools to better handle fiscal uncertainties.
- Budgeting reforms that focus on results have begun to shift attention to what government leaders and the public actually get for their money.

These initiatives are making significant strides in public governance. They have honed the budget process, making it a more open, accessible, focused, and effective tool for establishing priorities and managing the business of government. Many of the reforms have made the public more a part of government decisionmaking and far more aware of how tax dollars are spent on children and families. Others have developed and field-tested many of the tools necessary to budget for results.

States and communities are untangling budgetary webs of old and new policy choices, eliminating wasteful spending, consolidating overlapping programs, and negotiating conflicting priorities. They are starting to define the results they want from education and other public programs for children, and have begun to track whether our investments are successful. As states and communities struggle to do more with fewer public dollars, they are beginning to develop and use the tools that help us see what we get for our money and whether it is paying off.

Taken together, states, localities, and federal agencies are creating a wealth of knowledge about coherent budgeting policies and practices—an array of concepts and strategies that form a solid foundation for reforms yet to come. They have come a long way in the past decade to move public budgeting out of the shadows of dry statistics and confusing information. Much has been done. There is much more left to do.

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Center for Law and Social Policy, 1616 P Street, NW, Suite 150, Washington, DC 20036, (202) 328-5140

Child and Family Policy Center, 100 Court Avenue, Suite 312, Des Moines, IA 50309-2200, (515) 280-9027.

Government Accounting Standards Board, 401 Merritt, #7, Norwalk, CT 06568, (203) 847-0700.

Harvard Family Research Project, Harvard Graduate School of Education, 38 Concord Avenue, Cambridge, MA 02138, (617) 495-9108.

National Association of Counties, 440 First Street, NW, Washington, DC 20001, (202) 393-6226.

National Association of State Budget Officers, 400 N. Capitol Street, NW, Hall of the States, Suite 299, Washington, DC 20001-1511, (202) 624-5382.

National Conference of State Legislatures, 1560 Broadway, Suite 700, Denver, CO 80202, (303) 830-2200.

National Governors' Association, 444 N. Capitol Street, NW, Washington, DC 20001-1512, (202) 624-5300.

National League of Cities, 1301 Pennsylvania Avenue, NW, Washington, DC 20004, (202) 626-3000.

Reinventing Government Network, 275 E. 4th Street, Suite 710, St. Paul, MN 55101, (612) 223-8371.

The Urban Institute, State Policy Center, 2100 M Street, NW, Washington, DC 20037, (202) 833-7200.

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Arizona Office of Strategic Planning and Budgeting, Office of the Governor, 1700 West Washington, Suite 500, Phoenix, AZ 85007, (602) 542-5381.

Children's Advocacy Institute, 5998 Alcala Park, San Diego, CA 92110, (619) 260-4806.

City of Charlotte, Office of the Mayor and City Manager, 600 East Fourth Street, Charlotte, NC 28202, (704) 336-2241.

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BACKGROUND: BETTER PARTNERSHIPS FOR DISTRIBUTING PUBLIC FUNDS **77**

States and communities are being pushed by numerous forces to re-examine and reshape partnerships—between different levels of government and between public and private organizations—to better serve children and families.

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CHAPTER 4: DEVELOPING PARTNERSHIPS

BACKGROUND: BETTER PARTNERSHIPS FOR DISTRIBUTING PUBLIC FUNDS

Who is fiscally responsible for public programs serving children? Which level or combination of governments can most efficiently raise required revenues? How can government distribute those revenues equitably? Which level of government controls the purse strings? Who carries out the programs? And how can the public sector partner with the private sector effectively?

Answers to these and related questions are critical. They determine how well America's intergovernmental system is doing not only to raise and disperse public funds, but also how well this system is financing the programs that directly affect children and their families.

The American system for raising public revenue and expending those funds is highly complex. Some experts have likened the system to a marble cake, involving a rather unordered mix of both government and non-government players, programs, and financing processes, each of which blends into the current system.

In addition to the federal government and 50 state governments, nearly 85,000 local governments—including counties, municipalities, towns, school districts, and special purpose districts—generated and/or spent public funds in the United States in 1992. Although many programs are directed and administered by the same unit of government with responsibility for generating revenues, program funds are often raised by one level of government and distributed to other units of government to administer the programs.

Among its other responsibilities, government performs three types of functions: (1) ensuring that funds for public services are channeled to their appropriate uses in an efficient manner, (2) determining who should pay for or benefit from public services, and (3) taking action to ensure a stable and smooth working economy. There is general agreement that policies to maintain economic stabilization—such as controlling the money supply and interest rates—are best pursued by the federal government. However, there is considerable disagreement over which levels of government should be responsible for the other two functions. Political scientists, economists, and politicians have long debated these issues.

The current American system for financing education and other children's services involves partnerships among many governments and between the public and

OVERVIEW

Chapter 4, *Developing Partnerships*, dissects the intergovernmental system and explores ways to make partnerships among federal, state, and local governments, as well as private organizations, more efficient and productive. The chapter begins by describing the changes already under way in the intergovernmental system as pressure mounts to delegate authority to lower levels of government and reduce mandates on state and local governments. The chapter also highlights some opposite trends, such as a growing state role in school finance driven partly by court rulings that demand more equity in school finance. It then reviews the major options for policymakers to respond to these pressures. Topics include the pros and cons of different approaches to realigning governance, financing, and service delivery, such as sharing tax revenues, creating special purpose districts, and consolidating or expanding government boundaries. The chapter also reviews ways to realign intergovernmental responsibilities through mandates, and the devolution or centralization of responsibility for services, as well as block, categorical, matching, formula, and competitive grants.

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private sectors, although the particular finance arrangements differ depending on place and the services in question. Education funds, for example, mostly come from states and localities, while federal and state governments primarily raise funds for other children's services.

[redacted]

FOUR TRENDS COMPELLING INTERGOVERNMENTAL FINANCE REFORM

Efforts Are Under Way to Reform the Federal Grants-In-Aid System
Congress and the White House have taken decisive action to consolidate categorical programs, block grants, simplify reporting requirements, etc.

Court Decisions Have Changed the Policy Context in Many States
Some state governments are virtually recreating school financing systems in order to comply with court rulings regarding adequacy and equity in funding.

Health Care Costs Are Rapidly Rising
As these costs consume larger and larger portions of state government budgets, states are looking to change the intergovernmental relationships that have an impact on health care and other affected programs.

Federal Waiver Processes Have Afforded Increased Flexibility
States can draw down Medicaid and other federal funds—and spend them in new and creative ways. Through this mechanism, the federal government has allowed states to experiment with alternative finance and program arrangements.

[redacted]

IN DETERMINING APPROPRIATE STATE AND LOCAL RESPONSIBILITIES FOR FINANCING CHILDREN'S SERVICES...

Consider This Factor...	For Example, Can...
Efficiency	● Better services be provided from moving functions to a larger or higher level of government—and with additional savings? ● Benefits be provided best by districts with single or multiple purposes?
Equity	● Resources be redistributed to ensure that all children receive the necessary support and services? ● Alternative governance arrangements promote fairer service delivery systems?
Responsiveness	● Public programs and services meet children's needs in a timely manner? ● Service providers respond quickly to the concerns of parents and others?
Incentives	● Current programs promote well-educated and healthy children and accomplish the desired results? ● Policies and practices stimulate other levels of government to provide services most efficiently?[1]

Three Broad Strategies for Reform

Policymakers should consider whether current intergovernmental arrangements and public-private partnerships for financing education and other children's services are serving children and families well. If reform seems beneficial, then federal agencies, states, and localities can restructure finance arrangements for children's services through three general approaches. They are:

- *Realign governance, financing, and service delivery.* These options change the roles and responsibilities for program governance, financing, and delivery of different governments—through the creation, for example, of special purpose districts for children's services or the consolidation of existing school districts to enhance equity. Another option is to expand public-private partnerships.
- *Restructure intergovernmental grants-in-aid.* These options provide alternative arrangements for distributing grant funds among existing governmental entities.
- *Reform grant allocation practices.* These options address even more micro-level considerations, thereby highlighting key choices that must be made when designing different types of grants-in-aid.

STRATEGY 1: REALIGN GOVERNANCE, FINANCING, AND DELIVERY

Many structures exist for governing, financing, and providing children's services. They vary considerably in states and communities across the country. In the education arena, for example, independent local school districts operate schools in 33 states, with monies raised by local, state, and federal governments to support them.

In 12 states, independent school districts operate schools in some parts of the state, while county, municipal, town, or state governments operate them in other areas. In the remaining five states and the District of Columbia, all schools are operated as agencies of a general purpose government either at the city, county, or state level. Similarly diverse structures for governing, financing, and providing services exist for other children's services.

Realigning governance, financing, and service delivery arrangements among various governments and the public and private sectors is one approach for building stronger partnerships. State and local governments can choose among five realignment options: (1) sharing tax revenues, (2) creating special purpose districts, (3) consolidating governments, (4) realigning intergovernmental responsibilities, or (5) expanding public-private partnerships.

▼ Option 1: Share Tax Revenues

Governments within a geographic region can share a tax base, pool their tax resources, and reallocate them across jurisdictional boundaries. Many revenue-sharing plans are created to finance services that can extend beyond jurisdictional boundaries. Most tax-sharing plans combine local (as opposed to state) resources. Thus, when two or more governments agree to share revenues, they typically combine their funds from one of the two most important local tax sources: property taxes or sales taxes. Property tax-sharing plans are more prevalent because relatively few local areas have the authority to levy sales taxes.

Revenue-sharing plans are good options for states to enhance equity because they may permit resources to be shared more equally among participating local jurisdictions. They are particularly important options for states with "missing taxes"—states that do not impose one or more broad-based taxes. These states tend to rely heavily on existing revenue sources. And, unless they balance or diversify their revenue systems, they will have more difficulty improving equity by generating additional public dollars than other states. For more discussion of this topic, see Chapter 2: *Generating Revenue*.

When implementing a tax-sharing plan, governments may opt for one of several revenue-sharing strategies.

▼ *Pool All Resources Across Districts and Share Revenues*

Local taxing districts can elect to maintain their individual identities and jurisdictional responsibilities, yet combine and share all the revenues raised separately.

▼ *Pool Resources Above a Given Level*

Collaborating governments can set a common revenue threshold for each government to use when distinguishing between its own revenues and revenues to be commonly shared. Revenues raised below the threshold are kept for spending within the jurisdiction. Revenues collected above this threshold are pooled with revenues from other jurisdictions and allocated jointly across government boundaries.

▼ *Share Revenue Generated from Growth*

In this scheme, participating governments share all additional revenues earned after the plan's inception. The revenue levels of each jurisdiction prior to the plan's start serve as baselines. Funds raised above these baselines are pooled and shared. Revenue growth may come from a number of sources—for example, new development or property value increases.

▼ *Choose Selected Tax Bases to Share*

States and regions may choose to share revenues generated from one or more sources. For example, local jurisdictions might share revenues raised from all property taxes and general sales taxes, or revenue raised only from residential property taxes or from business property taxes.

▼ Option 2: Create Special Purpose Districts for Education or Other Children's Services

Another governance restructuring alternative for state and local leaders to consider is creating *special purpose districts*, as opposed to general purpose governments, to provide children's services. Special purpose districts have substantial administrative and fiscal independence, raising their own revenues and governing how they are spent. Procedures for creating special districts vary by state. Citizens can create them either through state legislation or by local action, pursuant to state law.

The two types of special purpose districts are *school districts* and public entities known as *special districts*—independent, special purpose government units other than school districts. A special district typically provides a single service or related set of services.

[redacted]

Special purpose districts provide a direct link between revenues raised and the services they provide. Thus, they may be politically palatable to voters, who often are willing to pay additional taxes for particular purposes but are wary about supporting general governmental activities. Additionally, special purpose districts can "free up" general purpose tax dollars by reducing the responsibilities that general purpose governments assume. For these reasons, creating special purpose districts represents an important option for states where debt and tax restrictions limit the abilities of general purpose governments to provide adequate services for children and their families.

[redacted]

A PIONEER: PALM BEACH COUNTY CHILDREN'S SERVICE DISTRICT

Background

- In the late 1980s, citizens of Palm Beach County, Florida created the Children's Services Council, an independent, special district of local government.
- The creation of the district followed the passage of a state law empowering Florida counties to create independent special districts for children's services.

Legal Roles and Authority

- "Plan, coordinate, fund, and evaluate programs, and… address public policy issues relating to children in Palm Beach County."
- Authority to levy up to one-half mill in property taxes to finance activities supporting children's services—granted by the passage of a county referendum.

Initial Funding Priorities

- Substance abuse prevention
- Education
- Recreation
- Child care
- Juvenile justice
- Health
- Developmental disabilities
- Dependency

Source: Healthy Children: Special Taxing Districts for Children: A Powerful Idea from Florida.

The large number of special purpose districts within the United States attests to their popularity and utility in providing particular services. In 1992, over 14,000 independent school districts[*] and more than 30,000 special districts[†] were reported in the United States. A large number of special purpose districts raise funds for purposes other than education or other children's services. There are special purpose districts that raise funds for drainage and flood control, soil and water conservation, fire protection, and public utilities—and, of course, services to children and families. States and localities may opt to establish special purpose districts for a number of programs serving children.

▼ *Create Independent School Districts*

States administer and operate public schools differently. Thirty-three states provide education through independent school districts only, while education in 12 states is provided by both independent and dependent school districts. Alaska, Hawaii, Maryland, North Carolina, Virginia, and the District of Columbia do not have independent school districts.

▼ *Organize Special Purpose Districts to Provide Multiple Children's Services*

A few special purpose districts, such as the Palm Beach County Children's Service District, have been organized to provide children's services other than education. They address the multiple needs of children and their families by providing a variety of children's services—for example, child care, substance abuse prevention programs, and healthy-child initiatives.

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[*] According to the Census Bureau, 15,834 school systems existed in the United States in 1992. The majority of these (14,422) were independent districts. Approximately 1,500 school systems were considered dependent agencies of other governments.

[†] The majority of these districts were found in nine states: California, Colorado, Illinois, Kansas, Missouri, Nebraska, Pennsylvania, Texas, and Washington.

▼ *Establish a Special District to Provide Targeted Assistance for Children and Families*

Local communities may elect to form a special district that provides a single service for children and their families. Districts providing services for children include housing and community development districts, library districts, and health districts.

Many communities provide services for children through these districts. For example, all but seven states have special purpose districts that fund housing and community development. Over two-thirds of these districts receive funds from other governments, either in the form of grants, shared taxes, rental fees, or cost reimbursements. Over 1,000 special districts—located primarily in Illinois, Indiana, Kentucky, and Missouri—provide library services to children and their families.

Twenty-eight states have special purpose districts that provide public health services. Most of the special health districts are fully staffed up for direct provision of services, which is particularly valuable for children and families who live in rural and sparsely populated areas of the country where access to health care may be limited.

▼ Option 3: Consolidate Governments or Expand Government Boundaries

Realigning governance responsibilities by consolidating governments or expanding government boundaries is yet another option for improving partnerships to better serve children and their families. Government consolidation realigns governance

TEXAS LAW OFFERS LOCAL DISTRICT CONSOLIDATION OPTIONS

Local Choices Promote More Equitable System

Passed in 1993, the state law requires high-revenue school districts to choose among several alternatives to promote more equitable financing:

- *Consolidation* to reduce districts' equalized wealth level below $280,000 per student. Voter approval is not required.
- *Detachment and Annexation* to transfer property from one district to another for tax purposes. Voter approval is not required; annexation is permanent.
- *Tax Base Consolidation* to create a new taxing district. Voter approval must be obtained from all participating districts.
- *Purchase of State Attendance Credits* to increase local school districts' weighted average daily attendance (WADA), thereby reducing their equalized wealth per WADA. This option requires voter approval.
- *Contract for Education of Non-Resident Students* from other districts to reduce equalized wealth per WADA to a more equitable level. This option also requires voter approval.

Local Preferences

- Most popular among districts are options that do not involve governance changes.
- High-revenue districts usually choose either to purchase attendance credits from the state or to pay for the education of non-resident students.

responsibilities by redrawing existing regional boundaries, combining two or more contiguous districts. Alternatively, local jurisdictions may expand their boundaries to include citizens in previously unincorporated areas.

Government consolidation offers a number of advantages for community leaders who want to redesign intergovernmental relationships to be more child-friendly. Expanding local government boundaries may be particularly effective in improving fiscal equity by broadening the revenue base for participating jurisdictions. Thus, district expansion may be an important option for states struggling to improve their school financing system in light of legal challenges. It can also be an important option for promoting a more efficient government because it may permit merged districts to capture savings by centralizing the delivery of certain services.

The laws governing procedures for consolidating different jurisdictions vary by state. City consolidations are authorized in 42 states, with the bulk of them requiring a majority of citizens in both cities to approve the consolidation through public referendum. Consolidations of cities and counties are permitted in far fewer states; only 14 states authorized such mergers in 1990. City annexations are allowed in 44 states.

▼ Option 4: Realign Intergovernmental Service Responsibilities

Another set of options to alter the roles and responsibilities for public services and supports for children and their families produces indirect changes to intergovernmental partnerships and financing arrangements. They focus on changing governance arrangements between different levels of government. Specifically, states may mandate local governments to perform particular functions, uphold standards, or operate within a particular set of financial or other constraints. Alternatively, states may reduce the powers of local governments, assuming the responsibility for services traditionally provided by local governments.

These options can represent attractive alternatives that may make the delivery of services—whether they be education, child care, or community development—either more effective in meeting the needs of children, more efficient in using scarce public resources, or more equitable to those being served. Although often prompted by other policy considerations, efforts to realign intergovernmental service responsibilities can have significant implications for state and local finance arrangements.

▼ *Mandate Lower Levels of Governments to Provide Services*

Concerned legislators, advocates, and citizens seeking to improve services to children can opt to have them mandated—thereby altering governance and finance arrangements among the different governments. Federal and state mandates affecting programs for children and families may take a variety of forms. Mandates may stem from statutes, court decisions, or constitutional or regulatory provisions imposed by a higher level of government compelling a lower level of government to perform a certain function.

Mandates can be effective in achieving positive outcomes for children and their families. However, as mandates have proliferated, so have resistance and lack of responsiveness on the part of lower levels of government. The hue and cry about "unfunded mandates" has been a cause of growing concern over the last decade. It is therefore important that policymakers carefully understand and weigh the advantages and disadvantages of mandating services and other conditions before they embark on such a change strategy.

To offset stakeholder concerns about proposed mandates, many federal agencies and states encourage open discussions and solicit direct input from stakeholders regarding the ramifications of different proposals. During this process, methods for obtaining full or partial reimbursement of mandated costs may be considered. The options available for reimbursing costs include: direct payment for services, cost reimbursement for administration or enforcement, authorization for user fee assessment, and in-kind provision of services.[2]

MANDATES

Some Key Types

- Protections for certain groups of individuals, often minority groups.
- Rules governing local governmental organizations and processes.
- Rules to prevent unproductive competition among neighboring localities.
- Laws that promote general public well-being by promoting a healthy, educated population.
- Rules governing permissible tax bases and other public financing arrangements.
- Minimum standards and conditions for employment.

Arguments For

- Permit citizens to place restrictions on themselves.
- Provide legal and financial support for groups that otherwise would be underrepresented.
- Guarantee minimum levels of service not otherwise available.
- Often, especially when enforced by constitutional provisions, offer more direct forms of governance than those enacted by representatives of the electorate.

Arguments Against

- Can impose service requirements on lower levels of government without providing them sufficient funding to meet mandates.
- Reduce freedom of jurisdictions to allocate resources according to their preferences.
- Can generate unnecessary costs by requiring adoption of constraints that are not efficient or cost-effective in meeting mandates.

▼ *Assume Traditional Local Responsibilities*

Another approach for states to consider in realigning government relationships is to assume some traditional local responsibilities. In the United States, local governments derive their power to provide services and/or levy taxes from state constitutions or statutes. State governments can choose to revoke this privilege and instead assume responsibility for delivering services traditionally provided by local governments.

Examples of cases where states have chosen to exercise this option can be found in the education arena. New Jersey, for example, has assumed responsibility for managing several school districts that failed to meet state standards in a number of areas.

▼ Option 5: Expand Public-Private Partnerships

Another important option for policymakers seeking to realign governance, finance, and service delivery is to expand public-private partnerships. These partnerships bring in additional sources of money and expertise that help bring high-quality programs to scale. Although public-private partnerships are often required by legislation or mandates, many are formed voluntarily in a way that reflects the interests and strengths of the partners.

There are other important advantages to public-private partnerships, which are found in almost every area of children and family services—particularly child care and early education; elementary and secondary education; and health care. First, community-based, non-profit organizations such as YMCAs, and religious groups like Catholic Charities, have often been leading providers of a broad range of services to children and families. They have the expertise and community roots to contribute to successful collaborations. Second, private support can promote long-term planning by providing financial support that goes beyond the next one-year public appropriations cycle. Third, private assistance—whether from a philanthropic foundation, business, or non-profit group, or some combination of all three—adds planning and financial management resources that help stretch dollars further. Fourth, private participation builds support and commitment to the program or initiative by giving all sectors of a community a stake in its success. Several examples will illustrate these points.

The *Illinois Facilities Fund* (IFF) is a non-profit corporation that draws on public and private resources to provide capital to disadvantaged communities. IFF was created by the Chicago Community Trust, a private foundation that provided a $2-million grant to serve as equity. IFF also received a $1-million loan from the Illinois Development Finance Authority, a public agency, as reserve funds.

> **There are important advantages to public-private partnerships, which are found in almost every area of children and family services—particularly child care and early education; elementary and secondary education; and health care.**

In partnership with the Illinois Department of Children and Family Services, IFF used those resources as security to borrow $13 million through tax-exempt bonds to construct five child care centers and renovate two additional centers. The centers often include family centers and health clinics, and are located in distressed neighborhoods where the need for child care is particularly acute. These centers provide care to more than 1,400 children. The Illinois Department of Children and Family Services repays the debt over 10 years, while IFF owns the centers and leases them to child care providers for $1 per year. Ownership of the facilities will revert to the child care programs when the mortgages are repaid.

New Jersey's *School-Based Youth Services* program, initiated in 1988, brings together education, health, and human services at 37 one-stop service centers—located at or near schools—for adolescents and their families. All of the centers provide primary and preventive health services; referrals to health and social services; individual and family counseling; crisis intervention; drug and alcohol abuse counseling; job training and placement; and recreation. Each site costs the state approximately $200 per student, but the state also requires each host community to fund at least 25 percent of the program costs through a direct financial contribution or in-kind services, facilities, or materials.

New Jersey stretches program dollars further through this required match and thus ensures community support and involvement at the same time. Businesses and non-profit groups contribute to the community match in many sites. At Plainfield High School, for example, the New Jersey chapter of the National Committee for the Prevention of Child Abuse, in partnership with AT&T, collaborated with public agencies to develop a comprehensive teen parent program, including school-based child care, parent education and support groups, and life-skills training.

STRATEGY 2: RESTRUCTURE INTERGOVERNMENTAL GRANTS-IN-AID

Another direction available to policymakers for improving the partnerships that finance education and other children's services involves restructuring our nation's intergovernmental system of grants-in-aid. There are three basic restructuring approaches: (1) designing effective general grants; (2) creating broad-based or block grants; and (3) redesigning categorical grants.

▼ Option 1: Use Effective General Grants

General grants, or unrestricted funds for general operational support, can be one grant option used to finance education and other children's services.

Unrestricted federal grants are relatively rare. The best-known example is the General Revenue Sharing Program, begun in 1972 and ended in 1987. This federal program provided revenue to states and local governments based on a formula that incorporated population, per capita income, and tax effort. The majority of the funds went to local governments under this program.

Unlike the federal government, many states award general grants. States use a variety of methodologies to distribute funds to local governments. In 1985, for example, general funds were allocated among communities according to one of the following criteria: (1) success in generating the funds in question (returning revenue to its origin), (2) demonstrated need for public programs, or (3) need for local tax relief.

Unrestricted state grants have not been found to be as effective as the federal revenue-sharing program in reducing fiscal disparities among recipients, since many have allocated funds on a return-to-origin or a per capita basis. Nevertheless, general grant programs that allocate funds based on local fiscal capacity can reduce disparities between jurisdictions.

When revamping grants-in-aid for education and other children's services, policymakers should consider using general grants to allocate funds. If properly structured, general grants may be a very efficient method for distributing public funds. This approach to restructuring grant assistance is very popular with recipient governments. General grants are unrestricted; they do not place constraints on how recipient governments can use grant funds. However, because of this flexibility, they may be

WHEN REFORMING GRANT ALLOCATION MECHANISMS...

Look for Opportunities Such As...

Leadership Changes
Nail down commitments by a newly elected governor, mayor, legislator, or other government official to reshape the intergovernmental system.

Legacy
Help a government leader retiring from office affect a positive change by restructuring grants for children's services.

Public Concern
Leverage real or perceived public anxieties by creating new grants or reforming existing ones.

Revenue Shortfall
React strategically to cutbacks with intergovernmental changes that will bring longer-term, sustained payoffs.

Federal Changes
Respond to alterations in federal programs by enacting positive changes.

less desirable than block grants or categorical grants for allocating money to education and other children's services.

Nevertheless, general grants are good alternatives for achieving a number of important objectives, which makes them valuable alternatives for policymakers to consider for financing education and other children's services. In particular, they permit grantmaking governments to allocate funds to recipient governments that are more efficiently raised at higher governmental levels. They also reduce fiscal disparities among recipient jurisdictions.

▼ Option 2: Create and Implement Block Grants

Block grants are broad-based categorical grants that require recipient governments to use their funds for certain types of activities, but which permit program administrators more flexibility in spending program funds than do targeted, categorical grants. Proponents contend that block grants are a desirable option for states and communities because they may significantly reduce administrative costs associated with tracking program funds, and thus may be more efficient than more narrow or categorical grants. In addition, they permit states and localities additional flexibility to pursue innovative and experimental program approaches and to best use the funds to meet the particular needs of the local jurisdiction.

Block grants from both the federal government and state governments are important sources of funds for children's programs. At the federal level, most block grants are distributed to state governments, although some go to local governments such as cities, counties, or school districts. One of the largest federal programs to support children and their families, the nation's welfare program, was recently converted to a block grant.[3] At the state level, many states have consolidated numerous categorical programs into block grants.

Policymakers from dispersing governments—whether they be the federal government or state or local governments—need to consider how to distribute block grant funds to recipient jurisdictions so that they promote effective, efficient, and equitable education and other children's services. When creating block grants, policymakers must grapple with some of the same questions raised in determining how best to distribute categorical funds: What type of grant allocation mechanisms should be used to disperse funds? Who should be eligible for receiving funds? Should any accountability restrictions be imposed on recipients?

WELFARE: ONE OF THE NATION'S MOST IMPORTANT BLOCK GRANTS FOR CHILDREN AND THEIR FAMILIES

Under the New Intergovernmental Arrangements...

- States saw a significant change in the intergovernmental system for funding children's services in 1996.
- The federal government overhauled the welfare program, one of the largest public programs supporting children and their families.
- In undoubtedly the most sweeping change, the new legislation converted welfare to a block grant to states for time-limited support for children and their families.
- The open-ended entitlement that had been in place for over 60 years, Aid to Families with Dependent Children (AFDC), was eliminated.

The New Welfare Program...

- Requires adults in families getting assistance to work within 2 years of receiving aid.
- Imposes a five-year lifetime limit on each family's benefits.
- Cuts aid to legal immigrant families who lack U.S. citizenship.
- Tightens eligibility requirements for children receiving Supplemental Security Income.

Also, grantmakers need to consider the best mechanisms to ensure that funds are spent to reach the desired objectives, that adequate financial resources are allocated to support those objectives, and that aid is actually reaching children and their families efficiently. Because primary program responsibilities are transferred to recipient governments under a block grant program, these governments should consider instituting practices to maintain fiscal and management accountability for reaching program goals and objectives.

▼ Option 3: Redesign Categorical Grants

Categorical grants are those that fund a specific activity or program. Categorical grants are considered to be an efficient method for distributing program funds because they ensure that monies are spent on a fairly narrowly defined activity, thus enhancing both political and fiscal accountability. Examples of well-known categorical programs that provide supports and services for children and families include Medicaid, Title 1, the school lunch program, and special education.

Categorical grants are popular at both the state and federal levels. In 1995, the overwhelming majority of federal grants to state and local governments, 89 percent of total outlays, were categorical grants.[4] Categorical grants are also used extensively by state policymakers to allocate funds to local governments for various supports and services for children and families.

Categorical grants are targeted. They often require that recipient governments construct administrative structures to ensure that program funds are not used for non-program objectives. These structures lead to some of the disadvantages of categorical funds. First, they require more administrative oversight than general or block grants in order to ensure that funds are spent properly. Second, they can create barriers to effective service delivery at the local level by restricting the ways in which funds can be spent.

Often, children or families have overlapping needs that are addressed through multiple supports and services provided by different agencies or departments. Categorical program restrictions may prevent service providers (a child welfare worker, for example), the flexibility to coordinate with other service providers in order to offer related services cost-effectively or to tailor services for a child or family in a way that best addresses their needs.

STRATEGY 3: REFORM GRANT ALLOCATION MECHANISMS

In addition to restructuring options—reforming grants as general grants, block grants, or more narrow, categorical grants—grantmaking governments and organizations can reform grant allocation processes. Allocation processes determine how much each recipient locality or organization will receive and what conditions must be met to receive funds. There are several dimensions that can be considered: (1) whether to impose matching requirements, (2) whether to allocate by formula or on a project basis, (3) how to determine the appropriate level of resources for distribution, and (4) whether to limit funds.

Each of these dimensions represents a key choice for state and local policymakers who are constructing grants for education and other children's services. As with the other options discussed in this guide, the best choices for a state or locality to implement will vary according to the system of grants already in place and the wishes of the community. In each case, the best selection for structuring an effective grant will vary according to the particular type of service being funded—for example, many states and communities may not feel that it is appropriate to allocate funds for basic support services, such as foster care, on a competitive basis.

> **Each of these dimensions represents a key choice for state and local policymakers. In each case, the best selection for structuring an effective grant will vary according to the particular type of service being funded.**

▼ Choice 1: Require Matching Funds?

One critical choice for state and local policymakers constructing grants for education and other children's services is whether to require the community receiving the grant to put up some of its own money to match the grant funds. As discussed below, state and local grantmakers basically have two options: impose matching requirements, or grant funds without matching requirements.

▼ *Impose Matching Requirements*

Matching grants require recipient governments or organizations to match some portion of the funds given by the granting government, in order to receive funds. In these cases, the size of the grant allocated to a jurisdiction or group is determined by the amount of revenue allocated locally to support the activity.

For every dollar committed to the activity by the recipient government or organization, additional program funds are generated through the matching grant, although some matching grants are subject to caps. The total amount of funds generated depends on the program's matching rate and whether grant limits are imposed, with programs that have higher matching rates generating higher program funds for the recipient governments.[*]

Matching grants are favored by many economists, politicians, policymakers, and program administrators for a variety of reasons. In addition to providing additional funds to grantees for a given service or program, matching grants change the effective price of providing a service or running a program—in effect, making it less expensive to the recipient government or organization to operate a particular program or provide a particular service, because of the additional funds generated through the matching grant. As a result, matching grants usually stimulate greater spending than would be generated by a non-matching grant for the same activity.

In practice, matching grants may have different types of matching requirements. Grant-making governments or organizations may establish:

- Distinct matching rates to fund different types of eligible service recipients;
- Matching rates that vary depending on the type of activity being supported;
- Matching requirements that adjust over time; or
- Grant guidelines that do not specify the exact matching rate. In these cases, matching rates are usually negotiated on a case-by-case basis.

The federal government's foster care program illustrates how a variable matching grant works in practice. Under the program, states receive between $0.50 and $0.83 in federal matching funds for every dollar they raise to support a child in foster care (the exact amount depends on the state, with low-income states receiving a higher match than those with high income). However, states receive only 50 cents for every dollar they raise to administer the program.

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[*] If r=matching rate, then the proportion of the program financed by the grant, m, equals $r/(1+r)$. Thus, for a matching rate of 1 (each dollar generates an additional dollar in grants), the proportion of the program financed by the grant is 50% $[m=1/(1+1)=0.5]$.

▼ *Grant Funds without Matching Requirements*

Non-matching grants do not require recipient governments or organizations to raise funds in order to receive money. These grants ensure that grant recipients will spend grant funds for particular activities or programs without making the grant amount contingent on the recipient's ability to generate revenues.

While non-matching categorical grants are designed to guarantee spending on a particular support or service, it is often unclear how much, if at all, these grants increase spending for a particular activity or service. Economic theory predicts, and numerous studies have shown, that a grant recipient may reduce its own spending in that area after receiving a non-matching grant for a particular service, instead shifting its resources to fund other activities. However, in cases where few jurisdictions or groups spend money on the service or program, or the amount of the grant is larger than would be spent by the grantee in the absence of the grant, the grants will increase spending in this area.

To ensure that grant funds are not used to supplant other money, policymakers may consider including *maintenance-of-effort* requirements in non-matching grants. Maintenance-of-effort stipulations are designed to prevent governments or other grant recipients from shifting their resources away from the particular service or support. A typical maintenance-of-effort provision requires states or localities to continue spending at previous levels, often expressed in dollars, in order to receive grant money. Maintenance-of-effort requirements may also be indexed to ensure that states or localities maintain their spending levels in real terms.

▼ Choice 2: Formula or Competitive Allocation?

State and local policymakers should consider the best methods for deciding which jurisdictions or organizations get funds for a particular activity and how much should go to each grant recipient. These decisions are particularly critical in the current policy environment, in which the federal government is devolving increased administrative and program responsibility for federal programs such as welfare to the states. State and local governments will now have to decide how to best allocate funds that had previously been allocated to different jurisdictions at the federal level. State and local policymakers need to choose between two methods: devising formula grants or creating project grants.

▼ *Devise Formula Grants*

Grantmakers can elect to distribute public dollars by formula—that is, *dispersing grant funds to eligible recipients on a pre-specified basis,* whether they be governments, organizations, or individuals. This option has the advantage of ensuring that there are mechanisms for distributing funds to all eligible grantees within a given jurisdiction's region. In contrast to competitive grants, formula grants also have the advantage of requiring less administrative resources. Grant award amounts are based on a variety of criteria, but are automatically determined. (See Choice 3: *Determining Appropriate Resource Levels*, for a discussion of the different type of criteria that may be considered.)

[redacted]

▼ *Create Project Grants*

On the other hand, grantmakers can distribute public dollars through *project grants*—dispersing funds on a selective basis and funding only chosen projects. The project grant mechanism often is used to pilot innovative programs, test non-traditional service delivery approaches, or distribute funds in cases where program funds are limited.

Grants may be awarded to different types of government agencies, service providers, or partnerships; however, the types of eligible grantees, proposal guidelines, and selection criteria vary greatly, depending on the particular objectives of the grant. Nevertheless, there are a number of common questions that states or local governments disbursing grants may wish to consider:

- Should the number of grantees be fixed, or be determined by the agency based on the number and/or quality of the applications received?
- Is the grant designed to provide funds using a proven approach, or using a novel approach that is untested but may result in advancing the state of the art or providing higher-quality services?
- Is it important to have regional or urban/rural balance for equity, or other types of considerations?
- Should grant amounts be fixed, or vary according to other criteria such as community needs or project scope?

[redacted]

GRANTS FOR EDUCATION OR OTHER CHILDREN'S SERVICES

When...	Consider Using...
Funding critical supports or services for children and families, such as basic education and health care	Formula Grants
Experimenting with novel, untested approaches that may advance the state of the art or provide higher-quality services	Project Grants
Concerned about regional or urban/rural balance for equity—or other types of considerations	Formula Grants
Limited funds exist for funding non-traditional supports or services	Project Grants

▼ Choice 3: Determining Appropriate Resource Levels

Policymakers can strengthen resource allocation processes by improving and tightening approaches for determining how much to grant each eligible jurisdiction or organization. Appropriate decision criteria will vary depending on the objective of the grants. There are three good ways to strengthen grant allocation mechanisms: (1) linking them to service needs, (2) adjusting for local revenue-raising capacity, and (3) ensuring the use of reliable cost estimates.

▼ *Link to Service Needs*

Calculating the need for education or other children's services involves determining how many children are to be served by a given program or service, and how the needs of this population are likely to change. Various indicators can be used to determine the need for children's services. Education need, for example, is related to the number of pupils in a district, and is commonly measured by either enrollment or attendance levels. Similarly, the number of families or children in poverty provides an indicator of an area's need for welfare, health, or other non-education children's services.[5]

Continued on page 95

Balancing Tradeoffs: Intergovernmental Grants for Education

State education aid illustrates how states must balance tradeoffs between different objectives when funding programs for children and their families. Some education grant mechanisms are very effective in accomplishing particular objectives—for example, promoting equity. Others do a good job of ensuring that adequate resources are provided to provide each child with a quality education.

This section discusses the relative merits of different education aid schemes and should be a useful resource to school board members, superintendents, parents, and others concerned with financing education. It should also be extremely valuable material to those concerned about financing non-education children's services, because of recent federal changes that will require states to take a more active role in balancing different policy objectives when constructing finance systems for children's programs. Under the new intergovernmental welfare system, for example, states will be increasingly called upon to assume a larger role in equitably allocating resources.

TABLE 4-1

STATE EDUCATION AID MECHANISMS 1993-1994

Full State Funding	Flat Grants	Foundation Funding		Reward for Effort Funding	Tiered Funding
Hawaii	Delaware[a]	*Local Effort*	*Local Effort*	*Percent*	Georgia
Washington	North Carolina	*Required*	*Not Required*	*Equalization*[d]	Missouri
		Alabama	Arizona	Connecticut	Texas
		Alaska	Arkansas	New York	Montana
		Colorado[b]	California	Pennsylvania	Oklahoma
		Florida	Idaho	Rhode Island	
		Iowa	Illinois		
		Kentucky	Kansas	*Guaranteed Tax*	
		Maine	Louisiana	*Base/Tax Yield*	
		Massachusetts	Maryland	Indiana	
		Michigan[b]	Nebraska	Wisconsin	
		Minnesota	New Hampshire		
		Mississippi	New Jersey		
		Nevada	North Dakota		
		New Mexico	Oregon		
		Ohio	South Dakota		
		South Carolina	Vermont		
		Tennessee	West Virginia		
		Utah			
		Virginia			
		Wyoming[c]			

[a] With separate equalization component
[b] Based on 1994 - 1995 System
[c] Based on 1992 - 1993 System
[d] Connecticut has a foundation type program with required local effort. New York and Pennsylvania have foundation type programs where local effort is not required.

Source: Steven D. Gold, David M. Smith and Stephen B. Lawton, *Public School Finance Program of the United States and Canada*, 1993-94. Vol. 1 (Albany, N.Y.: American Education Finance Association and Center for the Study of the States, 1995).

[redacted]

States use one of five basic mechanisms to distribute state aid for education. They are: (1) full state assumption of funding, (2) flat grants, (3) foundation funding, (4) district power equalizing and reward-for-effort plans, and (5) tiered-funding approaches. As discussed below, each of these has different advantages and disadvantages for obtaining various objectives.

Assume Full Funding

All state constitutions contain clauses that require the state to provide a statewide system of education. Few states, however, assume full financial responsibility for funding education. In fact, only one state, Hawaii, fully funds education. Washington state provides full funding for basic education in grades K-12, but school districts can choose to support supplementary programs through the imposition of local taxes and fees.

Nevertheless, full state funding is a good option for states if they wish to achieve a very equitable distribution of resources. However, it has drawbacks. This method considerably reduces local control over schools, and thus is often not a politically popular option.

Distribute Flat Grants

Only two states—Delaware and North Carolina—distribute flat or fixed grants to school districts. Flat grants allocate funds based exclusively on some measure of the district's education need, but do not take into account the area's ability to pay for services. Although flat grants have the advantage that they are simple to administer, few states use them because they can be expensive, even when grant levels are set relatively low. Flat grants also do little to promote a more equitable distribution of resources.

Guarantee Districts a Foundation Level of Resources

Foundation programs are used to distribute funds in a way that takes a local community's education need and ability to pay into account. They guarantee that school districts or local governments can spend a minimum, or foundation, level of resources to educate each child. Guarantees are typically expressed in terms of dollars per pupil.

[redacted]

HOW DO THEY STACK UP? COMPARISON OF STATE EDUCATION AID MECHANISMS

State Aid Mechanism	Ensure Adequate Resources	Reduce Fiscal Disparities	Provide Local Discretion	Ease of Administration
Full State Funding		▲	▼	▲
Flat Grant		▼		▲
Foundation Funding	▲	▼		
Reward-for-Effort Funding			▲	
Tiered Programs	▲	▲	▲	▼

Legend:

▲	Excellent for accomplishing objective
▲	Good for accomplishing objective
	No particular advantage or disadvantage
▼	Poor for accomplishing objective
▼	Very poor for accomplishing objective

Under a foundation program, the state sets the foundation level and a target local tax effort. State aid is then determined as simply the difference between the foundation level and the amount of local revenue generated given the state-determined local tax rate.[6] As seen in Table 4-1, forty states distribute state education aid primarily through foundation programs.

Foundation programs have an important advantage—per pupil or per child resource level is a critical variable in determining state aid. They also recognize both the state's interest in providing a statewide system of support as well as the local government's interest in maintaining local control by requiring both state and local government contributions.

Policymakers considering foundation programs will have to grapple with shortcomings in three areas: variance, adequacy, and cost. *Some districts may choose to spend considerably more than others*, potentially creating significant variability and inequity across jurisdictions. *State-determined foundation levels are not always set at an adequate level* to provide quality education or other children's services. Finally, while high minimum foundation levels increase equity, *they do so at a greater cost to the state*, making it necessary to raise additional revenues or cut programs outside of education—possibly other children's services.

Equalize Power or Reward for Effort

District power-equalizing programs, also called *reward-for-effort programs*, distribute funds based on need and ability to pay. An important option for promoting equity, they ensure that school districts or local governments have equal abilities to raise revenues, despite differences in their local property tax bases. They do not, however, ensure that the minimum levels of funds necessary to meet high standards are generated or spent on education.

Policymakers can consider three basic types of district power-equalizing programs. *Guaranteed tax base* programs guarantee jurisdictions the ability to generate tax revenues as if they have a certain state-specified tax base. *Guaranteed tax yield* programs guarantee jurisdictions the ability to generate a given level of revenue at specified tax levels. Under *percentage equalizing* programs, states match local spending on education at specified rates, which vary according to local fiscal capacity. All programs offer school districts considerable flexibility in setting tax rates consistent with their own tastes and preferences, but independent of their property wealth.

Reward-for-effort programs, however, have several disadvantages. First, school districts or local governments may choose different tax efforts and, as a result, considerable disparity may exist between the levels of services provided across jurisdictions. Second, districts or local governments may choose not to tax at levels necessary to provide an adequate level of services. In addition, it may be difficult to estimate the amount of state aid necessary to implement reward-for- effort programs initially, because of the typically large number of school districts involved and the relatively few restrictions placed on how much revenue they can choose to generate.

Tier State Aid

States may also opt to combine elements of different funding structures in order to promote greater adequacy and equity in funding education. Called a tiered approach, this approach is used by a few states to allocate state education aid, as seen in Table 4-1.

Under a tiered state aid program, states can combine the best features of foundation programs and district power-equalizing programs. Thus, the state can set a minimum resource level to ensure that resources are adequate to meet the educational or other service needs. By adding a second tier of state aid calculated using a power-equalizing approach, the state can also ensure fiscal equity above the foundation level.

Although the tiered method balances principles of equity and adequacy while permitting some local discretion, it has disadvantages too. Its primary downside is that it is complicated, and thus not easily administered. It requires states to have knowledgeable staff available who are capable of calculating the appropriate grant levels for districts.

▼ *Adjust for Local Revenue-Raising Capacity*

Policymakers need to consider a community's ability to generate resources to support public services when constructing grants for many services. One of the characteristics of a decentralized system of providing public services is that different communities have various levels of resources (e.g., different income or property tax bases) available to them. Differences in the resources available to different school districts, cities, or counties within a state implies that different communities are not able to provide comparable services with the same tax effort.

The federal government and state governments use various indicators of fiscal resources, each of which captures some aspect of a community's ability to generate resources to support public services. Common indicators include per capita income (usually used to measure state fiscal resources), or equalized assessed property valuation (usually used to measure fiscal resources at the local level—for example, for distributing education aid).

▼ *Use Reliable Estimates for Unit Costs*

The costs of delivering a particular service can vary considerably by state, locality, or organization. There are numerous reasons for these discrepancies, including differences in the methods of delivering services; different needs for ancillary or special services such as transportation or special education; and differences in the costs of needed inputs, including, most importantly, differences in salaries. For example, the cost of educating a child in New York City may be different from that of educating a child in a small rural town such as Blissfield, Michigan—not only because teacher salaries will differ considerably, but because of differences in class size, student populations, and education methods.

Grantmakers can take various approaches in order to determine the funding levels adequate to provide quality education or other children's services per child or family.[7] To estimate these costs, states and local governments employ various methods. Of particular note are two mechanisms: *calculating costs from resource models* and *estimating costs based on current patterns or historical trends in spending.*

Calculate Costs from Resource Models

Education agencies and others can estimate resource levels by determining the costs associated with a defined set of educational resources, such as teachers at different qualification levels. These models can vary considerably in their complexity and may be difficult to construct.

Estimate Costs Using Current or Historical Patterns

Because of the difficulties with constructing resource models, some states and local school districts use current or historical spending data to estimate the level of resources adequate to educate or provide health and human services for the average child—controlling for variables such as inflation or differences in local property wealth.

The main drawback with this method of estimating program costs, however, is that it assumes both that local providers have accurate knowledge about the level of resources needed to provide quality education and other children's services, and that they have access to the necessary funds.

▼ Choice 4: Cap Funding?

Some grantmakers limit or cap funds, while others do not. Choosing whether to impose a total funding limit on a particular program is a more important issue at the national level, because many federal programs are designed to promote economic stability and thus provide automatic grants, or *entitlements*, to eligible states or individuals.

Most state governments have a limited capacity to offer open-ended grants because of state balanced-budget requirements. Thus, it is particularly important for state and local policymakers to understand the effects of caps and limits on different programs.

Funding limits on grants may prevent states and localities from adequately addressing the needs of children and their families. This is especially true if the funds set aside by the grantmaking government are insufficientto address the needs for that service.

Further, if recipient governments do not have either a sufficient tax base or cannot generate sufficient political support for programs targeted to disadvantaged populations, grant caps may prevent children and their families from receiving critical services. In these situations, states or localities may be forced to make difficult choices: to employ waiting lists for critical services, to decide how to ration services, or to provide inadequate resources for educating and supporting children and their families.

SUMMARY

This chapter has outlined ways of improving partnerships among governments and between the public and private sectors in order to distribute public funds for children's programs. These options permit states and local governments to disperse funds more efficiently and equitably, with increased responsiveness to demonstrated need, and with incentives built into the system to achieve intended results.

Government's job of raising, distributing, and receiving funds to pay for public services is neither straightforward nor easy. Efficiency is important, as is dispersing financial burdens and gains appropriately across levels of government.

The national system for distributing public funds is complex. It is a seemingly disjointed mix of governments caught up in highly technical and often obscure fiscal and legal partnerships that have proliferated over the years. Involved are most federal agencies, 50 state governments and nearly 85,000 local jurisdictions, including counties, municipalities, towns, school districts, and special purpose government units. Experts liken the system to a marble cake: programs and funding streams swirl through layers of government.

There are several key approaches for restructuring existing roles and responsibilities that have withstood the test of time. There have been many successes and lessons learned about revenue-sharing; creating independent school districts and other special purpose government units; consolidating governments and expanding jurisdictional boundaries; imposing mandates for certain services; and expanding public-private partnerships. The Texas school financing plan is a new twist on an old theme, allowing local school districts to choose a method for restructuring the education finance system after courts declared the Texas system unconstitutional.

Revamping elements of America's system of intergovernmental grants-in-aid can improve the distribution of public funds for children's services among levels of government. Governments at higher levels can structure general grants more effectively and distribute them so that there is less fiscal disparity among recipient governments. They can create block grants and redesign categorical grants to provide recipient governments with both increased spending flexibility and reduced red tape—all without sacrificing fiscal accountability.

Grantmaking governments can improve upon grant mechanisms so that funds are distributed more effectively to grantees. They can impose matching requirements on grants and install maintenance-of-effort provisions in non-matching grants, or set funding limits on grants. They can strengthen the design and conduct of formula and project grants, improve upon methods used to determine level of resources granted to each eligible jurisdiction or group, and balance tradeoffs in structuring aid. To illuminate the critical need for balancing tradeoffs between different funding objectives, this chapter has provided an in-depth look at the mechanisms that states are using to better distribute education aid to localities.

NOTES

1 Hirsch and Rufolo, *Public Finance and Expenditure in a Federal System*, p. 67, and Rosen, *Public Finance*, pp. 509-514.

2 See U.S. Advisory Commission on Intergovernmental Relations, *Federally Induced Costs Affecting State and Local Governments.*

3 See Cheryl D. Hayes and Anna E. Danegger, *Rethinking Block Grants: Toward Improved Intergovernmental Financing for Education and Other Children's Services*, The Finance Project, April 1995, and *Dollars and Sense: Diverse Perspectives on Block Grants and the Personal Responsibility Act*, The Finance Project, September 1995, for further discussion of recent block grant proposals.

4 U.S. Advisory Commission on Intergovernmental Relations, *Characteristics of Federal Grant-in-Aid Programs to State and Local Governments*, p. 11.

5 See Martin E. Orland and Carol E. Cohen, *State Investments in Education and Other Children's Services: The Fiscal Challenges Ahead*, for further discussion of various indicators of need and how national estimates of the need for education and other children's services are predicted to change in the coming years.

6 Mathematically, the formula for determining state aid (SA) is SA = NF-rW, where N = number of pupils in the district, r = required local tax rate set by the state, and W = total district property wealth. For more information see, Steven Gold et al., *Public School Finance Programs of the United States and Canada, 1993-1994.*

7 John Augenblick and John Myers, "Determining Base Cost for State School Funding Systems," Issuegram, Education Commission of the States, February 1994.

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▼ *Strategy 3: Reform Grant Allocation Mechanisms*

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Who To Contact For More Information

Alliance for Redesigning Government, 1120 G Street, NW, Suite 850, Washington, DC 20005, (202) 347-3190.

American Public Welfare Association, 810 First Street, NE, Suite 500, Washington, DC, 20002-4267, (202) 682-0100.

Center for Study of Federalism, Temple University, Department of Political Science, 10th Floor, GladFleter Hall, 1115 West Berks Street, Philadelphia, PA 19122, (215) 204-1480.

Center for Law and Social Policy, 1616 P Street, NW, Suite 150, Washington, DC 20036, (202) 328-5140.

Consortium for Policy Research in Education. Graduate School of Education, University of Pennsylvania, 3440 Market Street, Suite 560, Philadelphia, PA 19104-3325, (215) 573-0700.

Education Commission of the States, 707 17th Street, Suite 1700, Denver, CO, 80202-3427, (303) 299-3600.

Families and Work Institute, 330 Seventh Avenue, New York, NY 10001, (212) 465-2044.

National Association of Counties, 440 First St., NW, Washington, DC 20001, (202) 393-6226.

National Association of State Budget Officers, 400 N. Capitol Street, NW, Hall of the States, Suite 299, Washington, DC 20001-1511, (202) 624-5382.

National Conference of State Legislatures, 1560 Broadway, Suite 700, Denver, CO 80202, (303) 830-2200.

National Governors' Association, 444 N. Capitol Street, NW, Washington, DC 20001-1512, (202) 624-5300.

The Social Compact, 5335 Wisconsin Avenue, NW, Suite 410, Washington, DC 20015, (202) 686-9190.

Welfare Information Network, 1341 G Street, NW, Suite 820, Washington, DC 20005, (202) 628-5790.

For More Information on Examples Provided in the Text

Children's Services Council, 3111 South Dixie Highway, Suite 243, West Palm Beach, FL 33405, (651) 655-1010.

Illinois Facilities Fund, 300 West Adams Street, Suite 431, Chicago, IL 60606, (312) 629-0060.

New Jersey Department of Human Services, Legal and Regulatory Affairs, Trenton, NJ 08625, (609) 292-1617.

CHAPTER 5: ALIGNING INCENTIVES

BACKGROUND: CRITICAL FORCES COMPELLING LEADERS TO RE-EXAMINE INCENTIVES 103

Budget constraints and public dissatisfaction with the quality of public services call attention to the way that incentives are structured for individuals and organizations providing services to children and families, as well as for those receiving the services.

STRATEGY 1: USE INCENTIVES TO EMPHASIZE PERFORMANCE 105

This section reviews four major ways to provide or increase incentives for service providers to deliver high-quality services to children and their families.

▼ **Option 1:** Pay for Performance 106
▼ **Option 2:** Contract for Performance 107
▼ **Option 3:** Exchange Flexibility for Performance 109
▼ **Option 4:** Establish Partnerships for Performance 111

STRATEGY 2: GIVE FAMILIES WITH CHILDREN MORE CONTROL OVER FINANCING 111

This section reviews incentives from a different perspective: that of the families receiving services. It examines some of the major options for transferring resources to the consumers of services so that providers have stronger incentive to respond to their needs.

▼ **Option 1:** Create More Demand-Driven Education Systems 112
▼ **Option 2:** Encourage Self-Sufficient Families through Demand-Driven Approaches 114
▼ **Option 3:** Create Efficient Incentives through the Tax System 115

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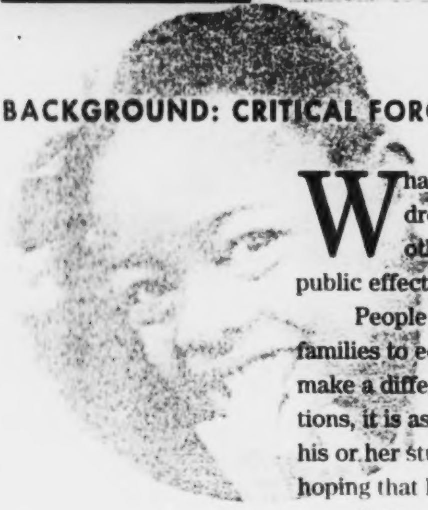
CHAPTER 5: ALIGNING INCENTIVES

BACKGROUND: CRITICAL FORCES COMPELLING LEADERS TO RE-EXAMINE INCENTIVES



What motivates people—particularly teachers and others working with children—to do a good job? How important are financial rewards, as opposed to other incentives? How can public-sector leaders inspire workers to serve the public effectively and efficiently?

People who enter public service, particularly those who work with children and families to educate and care for children, are typically motivated to help others, and to make a difference. Although many work for low pay and often under difficult conditions, it is as difficult to imagine a teacher going to work each morning determined that his or her students fail as it is to imagine a business executive heading to the office hoping that his or her company's profits decline.

If those employed in education and human service delivery systems—both front-line workers and program managers—aspire to help children and families, why aren't these systems helping to produce better results? How can associated management and financing systems provide incentives so that individuals' achievements do contribute to successful outcomes?

A number of critical forces are forcing state and local leaders across the nation to struggle with finding answers to these critical questions. These forces are prompting governors, state legislators, county executives, and others to explore the best incentive systems to encourage providers to work with children.

OVERVIEW

Chapter 5, *Aligning Incentives*, delves into the structure of public policies and programs to examine the role of incentives in promoting high performance and ensuring accountability. It reviews the pros and cons of the leading models for performance incentives: paying for performance, contracting for performance, exchanging flexibility for performance, and partnering for performance. The chapter also reviews an alternative approach to changing incentives—sometimes termed a "demand-side" approach—by putting resources into the hands of citizens seeking services, instead of changing the incentives for service providers and public agencies. Among the demand-side options reviewed are charter schools, school choice, individual development accounts, and tax incentives.

Public Pressure to Do More, Better, and For Less

In the 1980s, Americans received an unexpected wake-up call. The widely publicized 1983 report, *A Nation At Risk*, showed that the nation's schoolchildren—including our best-performing students—were not being adequately prepared for the workforce. Students were graduating without the skills and capacities necessary for a fast-paced, demanding, and highly competitive world economy. These startling conclusions provoked Americans to recognize that further attempts to channel additional money to education, in and of itself, would not guarantee greater student achievement. How wisely that money was spent mattered at least as much.

Today the challenge of "doing well" has shifted to "doing more, better, and for less." The current mood of citizens precludes spending more money, if at all possible. People are unwilling to pay more taxes, or tolerate public budget increases, until they see demonstrable improvements. Public opinion polls, political commentary and election returns have underscored the growing public discontent with how government works and how much it costs. Taxpayers want government to produce high-quality goods and services, reliably and affordably, which elevates the issue of *how well we spend the money we have.*

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Growing Recognition of the Need to Focus on "How Well," Not Just "How"

Previous state and local efforts to provide education and other children's services have built a web of policies and programs with a variety of interwoven incentives. Recent evaluations of these programs have found that many of these program guidelines have discouraged teachers, social workers, and other service providers from accomplishing more.

Past policies and programs provided incentives for state and local service delivery personnel to focus either on program accountability or fiscal accountability, not on outputs. In order to maintain program accountability, numerous state and local rules and regulations created incentives to ensure that program funds are spent for their specified purposes. State and local program administrators were directed to keep detailed records to show that only eligible children or families receive services or that programs comply with set rules. To maintain fiscal accountability, many incentives require officials to prove that money is competently managed by using reliable accounting practices to minimize fraud.

In essence, states and localities have become skilled at tracking *how* they do things, but not so good at making sure *how well* they turn out. However, adherence to procedures is not a sufficient proxy for accomplishment.

In the final analysis, after ensuring that public dollars are managed with integrity and used only for specified purposes, policymakers need to demonstrate that they have made a difference in the lives of children and families.

State and community leaders must do more to ensure that programs and policies encourage service providers, teachers, counselors, day care providers, and others to work towards common goals.

Greater Focus on Performance, Not Organizational Survival

While public servants providing education or other children's services are often highly motivated to help families, they, like most people, respond rationally to both incentives and disincentives imbedded in the system. Thus, when these incentives encourage service providers to take into account factors other than their clients' well-being, children and their families may suffer adverse consequences.

For example, a service-delivery unit might find ways to reduce administrative costs in order to redirect funds to assist clients, only to be informed that funds are not allowed to be used for this purpose. Or they may be told that their budget will be cut next year because, by being efficient, they have demonstrated less need for the money.

Similarly, a family case worker might see the benefit in working with a family on preventive measures. Too often, this effort is not rewarded, but rather reprimanded—for example, by auditors who maintain strict interpretations of how to use program funds.

The problems created by misaligned incentives are compounded by the fact that most of the public funding for human services goes to addressing problems once they appear, not ensuring the absence of problems. And problems are defined narrowly—e.g., teen pregnancy, child abuse, school dropouts—which reduces the incentives for public servants to deal comprehensively with service recipients.

Realigning Incentives for Better Performance

In response to these forces, innovative leaders throughout the nation have been trying to make government work better, smarter, and cheaper. Much of their effort has focused on realigning incentives in order to encourage better performance. State and community leaders must do more to ensure that programs and policies encourage service providers, teachers, counselors, day care providers, and others to work towards common goals. And these policies and practices must provide positive incentives for children and families to learn challenging material, remain healthy, and become self-sufficient.

This chapter explores a range of options that can help leaders improve education and other children's services by building incentives for high performance into these finance and service delivery systems. Recognizing that incentives can take many forms (including both monetary and non-monetary rewards) this chapter concentrates primarily on various options open to state and local communities to alter the incentives in their finance systems. It includes a variety of options, including options for restructuring pay schemes or granting authority over methods for spending funds.

Policymakers at the state and local level have two broad types of options open to them for realigning incentives to improve performance. The first group of options focus on the *supply side*, directly creating greater incentives for service providers to improve performance. The second group shifts the focus to the *demand side*—encouraging better performance by putting resources directly in the hands of families to meet the needs of their children, thereby giving service providers an incentive to be more responsive to those needs.

PERFORMANCE INCENTIVES FOR EDUCATION AND OTHER CHILDREN'S SERVICES

Increased Decisionmaking Authority

Opportunities for Advancement

Monetary Awards Tied to Performance

Flexibility to Spend Resources

Positive Recognition by Peers and Colleagues

STRATEGY 1: USE INCENTIVES TO EMPHASIZE PERFORMANCE

Decisionmakers should look carefully at ways to align the incentives in the system they hope to reform with the results that society wants to achieve. People respond to incentives, and incentives come in many forms. What authority people have, how people are trained, how they are rewarded by their peers and their supervisors, how flexible the financial resources and rules are, and how expectations of performance are established and communicated, all bear upon how well people perform.

Plans to align financial incentives for performance in education and other children's services range from individual pay-for-performance to bonuses for whole systems. States and communities have gained more experience with financial incentives in education than in other children's services, but the reality of shrinking federal support coupled with the public demand for improved outcomes has sparked new possibilities for aligning financial incentives in these systems as well.

State and local policymakers across the nation are restructuring financial incentives to encourage better education and other children's services. Many of these options provide financial or other rewards for high performance. Among the important options that states and local leaders should consider are: (1) pay-for-performance plans; (2) performance contracting; (3) exchange of flexibility for performance; and (4) performance partnerships. Regardless of which option is chosen, it is critical that state and local leaders work with service providers to structure the particular incentive plan carefully in order to reduce unintended, perverse consequences.

▼ Option 1: Pay for Performance

Pay-for-performance or *merit-pay* plans link the wages of an individual or group of individuals directly to performance. These plans seek to provide incentives for service providers—teachers, day care providers, and others—in order to reach certain goals. Those achieving agreed-upon goals receive additional compensation over and above their base pay. Based on the premise that money matters, the plans reward those who make a difference.

In education, merit pay is linked to student results, usually measured by test scores. Half of the states have some sort of teacher or school incentive program. As shown in Table 5-1, these programs are at different stages of development. In 1993, teacher or school incentive programs were still under development in some states, while in others they were either in the pilot stage or being implemented statewide. Many teacher pay-for-performance plans are implemented at the local rather than the state level.

Two other types of teacher pay-for-performance plans are mentor teacher plans and career ladder plans. *Mentor teacher* programs give experienced teachers increased pay for assisting, advising, and evaluating new teachers. These programs are relatively popular and are available in some form in 23 states. *Career ladder* programs link pay increases to a variety of additional tasks or roles that teachers may take on, such as curricular development, instructional supervision, or management and administration. For example, a particularly skillful teacher might be designated as a lead teacher for his or her department or school; with the increased pay would come additional responsibilities for curriculum, professional development, and instruction.

State and local governments contemplating pay-for-performance plans should be aware of a number of potential pitfalls. Employing pay-for-performance plans in education or other children's services has received mixed support, for a number of reasons. Some argue that rewarding individual workers encourages an unhealthy level of competition among teachers and/or service providers. This is a particularly important concern because cooperative, interdisciplinary approaches are considered essential in improving supports and services to children and their families. Others believe that performance bonuses are inappropriate in these fields because results in education and other children's services are influenced by many people. Rewarding the contributions made by particular individuals assumes that their contributions can be separated from those of others without difficulty—an assumption many find to be questionable.

One critical issue that state and local policymakers should address when designing a successful pay-for-performance scheme is establishing clear administrative procedures. Studies of these schemes have pointed out that when performance expectations were unclear or unfair, bonus policies were ambiguous, or if the organizations responsible for administering these programs lacked sufficient implementation capacity, the plans did not work as well as expected.

Recent efforts to establish financial rewards for performance address some of these design flaws. They reward teams of people working jointly to achieve the specified results. In Kentucky, for example, schools, rather than individual teachers, receive bonuses for achievement. Each school must meet targets for continuous improvement in student test scores in grades 4, 8, and 11. Schools reaching their targets receive bonuses. The school's faculty determine how the bonus is distributed.

TABLE 5 1

TEACHER PAY-FOR-PERFORMANCE PLANS 1993

State	Teacher Incentive	School Incentive	Mentor Teacher	Career Ladder
Alaska	Local			
Arizona				State
Arkansas			Development	
California			State	
Colorado	Local	Development		
Connecticut			State	
Georgia		State	State	
Hawaii			Development	
Idaho			State	
Illinois	Local			
Indiana		State	State	Local
Iowa	State			
Kansas	Local			
Kentucky		Development		
Louisiana		Development	Pilot	
Massachusetts			Development	
Michigan	Local			
Minnesota	Local		Pilot	
Mississippi			Development	
Missouri				State
Montana	Local		Pilot	
Nevada	Local			
New Hampshire	Local			
New Jersey	State		Development	
New Mexico			State	
New York	State	Development	Local	
North Carolina				Pilot
Ohio				Pilot & Development
Oklahoma	Local			
Pennsylvania		State	State	
Rhode Island			Pilot	
South Carolina		State		
South Dakota			Local & Development	
Tennessee	Development	Development		State
Texas		State		
Utah				State
Virginia	Local		Pilot	
Washington		Pilot	State	
West Virginia			State	
Wisconsin	Local		Local	
Wyoming	Local			

Legend:
Local=Local Initiative State=State Program Pilot=State Pilot
Development=State Program Under Development

Alabama, Delaware, Florida, Maine, Maryland, Nebraska, North Dakota, Oregon, and Vermont do not have teacher incentive, school incentive, mentor teacher or career ladder plans.

Source: Southern Regional Educational Board, 1994 Survey

▼ Option 2: Contract for Performance

Performance contracting also links pay to performance. *Performance contracts* are legal documents that link an individual's or group of individuals' pay to achieving a set of performance measures over a given period of time. This crucial link between compensation and performance, spelled out in the contract, can realign incentives for service delivery personnel to ensure that services are provided effectively and efficiently.

Many states and communities find that contracting for performance is an important option for providing more efficient public services. It is particularly attractive to states and localities seeking to find ways to provide quality services in an era of fiscal constraint. Performance contracts are commonly used when a private firm is hired to provide a public service. Several states and localities, however, have awarded performance contracts to public-sector employees, often after a competitive bidding process involving groups from both the public and private sectors. In both cases, performance contracts are increasingly seen as a way to clarify expectations and hold service providers accountable.

States have found that contracting for performance is best suited for services that lend themselves to quantitative performance measures. Thus, performance contracting is a good option for states, cities, or school districts seeking to provide a set number of meals or transport a given number of children to and from school. It may be more difficult to implement for services that do not readily lend themselves to quantifiable outcomes or where multiple objectives are sought, such as providing mental health care or quality education.

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In addition to specifying the desired outcome and determining a measurable unit of service, state and local leaders concerned with education and other children's services should think about two critical steps when constructing a performance contract. First, government leaders need to ensure that procedures are in place to monitor the contractor to obtain the desired results. This involves establishing reporting requirements; setting up regular meetings between government representatives and those from the group or agency performing the work; and thinking about who are the most appropriate individuals to monitor the work. It is particularly important to design the contract to avoid instances of "creaming"—when an agency or company meets performance targets by taking the easiest cases or best-prepared clients, while avoiding the most difficult cases or clients. To avoid this problem, the agency or company might have to meet stipulated performance targets for serving disadvantaged groups of children and their families.

TABLE 5-2

PERFORMANCE CONTRACTING IN EDUCATION

Service	Schools Using Contracting Services
Transportation	32%
Heating and Air Conditioning	27%
Computer Servicing	23%
Printing	23%
Food Service	22%

Source: The Reason Foundation

The other step is an equally critical one: subjecting the service to competition. Requiring multiple firms or groups of individuals to compete for the ability to provide a service encourages these groups to look for new methods of providing services. Although this may be difficult to implement for services that have not traditionally been provided on a contract basis, competition adds extra incentives for service providers to take full advantage of advances in technology or changes in service delivery that may improve service delivery or increase cost savings, or both.

Numerous states and localities have used performance contracts to provide selected children's services. In the education sector, performance contracting is often employed for support services. In fact, a 1995 survey found that 66 percent of the nation's school districts use at least one contracted service. As seen in Table 5-2, student transportation, heating and air conditioning, computer servicing, printing, and food service are the most common contracted services.

Performance contracting for other educational services is less common, although a few districts have begun to experiment with contracting for instructional or managerial services. Performance contracts for private groups to manage public schools exist in a handful of districts. In some cases, the contracts are only for certain schools; however, in a few areas, an entire district has awarded a contract to an outside agency to manage the district's schools. For example, the superintendent of the Minneapolis public schools is a private firm—the Public Strategies Group (PSG)—performing the job on contract. The Minneapolis Public Schools has entered into three consecutive contracts with PSG. While the accountability measures are evolving, the contracts specifically link pay to achievement, and the district withholds payment until certain targets are met.

Schools or districts have contracted for instruction in some communities. At the end of 1995, over 50 public schools in six states had contracts with Sylvan Learning Systems to provide remedial math and language instruction for disadvantaged students. Other schools have contracted with Berlitz, Jr. to provide foreign language instruction.

In other children's services, states are increasingly turning to performance contracts as a way to realign incentives for those involved in collecting child support payments. Approximately 20 states now contract for various activities, including locating those who owe child support payments, collecting and processing payments, and distributing funds.

In the welfare area, a number of cities are also experimenting with performance contracts. For example, in New York, Albany, Hartford, and Indianapolis, a private firm, America Works, provides job placement services for welfare recipients. The performance contracts specify that America Works receives its fee once its client holds a job with benefits, for a specified period of time, such as three months or six months.

▼ Option 3: Exchange Flexibility for Performance

Flexibility in exchange for performance plans essentially loosen the restrictions on the means that states and localities must use to deliver services and focus accountability on the ends. These plans do not disburse cash rewards as incentives. Instead, they provide a different type of incentive: increased authority over how program funds can

FEDERAL – STATE EXPERIMENTS EXCHANGING FLEXIBILITY FOR PERFORMANCE

The Goal...

To learn more about the best ways of moving a family from welfare into self-sufficiency, the federal government granted numerous waivers to states in order to test different approaches. Over 70 waivers to conduct demonstrations in approximately 40 states were granted.

States Used the Increased Flexibility to...

- *Alter the structure of incentives influencing welfare recipients directly.* Twenty-seven states, for example, helped people move from receiving welfare checks to earning paychecks by increasing education and training opportunities. Twenty-two states made welfare a transitional support system, often requiring recipients to develop personal employability plans and self-sufficiency agreements.
- *Encourage parents to work.* Many states increased the program's resource limits and earnings disregards in order to encourage work and savings. Some states also extended child care and/or Medicaid benefits to families after they left the welfare rolls.
- *Prevent children and families from needing assistance in the first place.* These states provided, on a voluntary basis, a one-time payment in lieu of welfare to meet a temporary need.
- *Strengthen parental responsibilities.* Eighteen states strengthened child support enforcement. Twenty-eight states encouraged parental education. Some states limited benefits for families who have another child while on welfare. Several states required children to attend school, be immunized, and receive regular health check-ups as a condition of receiving benefits.

In Return, States Had to...

- *Maintain cost-neutrality.* Any additional funds incurred because of state-sponsored changes to the welfare program must be assumed entirely by the state.
- *Conduct a rigorous program evaluation.* To help policymakers better understand the dynamics of moving from welfare to work, states must conduct rigorous program evaluations over the life of the demonstration. Jointly funded by the states and the federal government, the evaluations must include a net impact study to assess the impact of changes on various factors, including employment, earnings, and the length of time spent on welfare.

Source: Steve Sarner and Mark Greenberg, *The CLASP Guide to Welfare Waivers 1992 – 1995 and 1996 Updates*, Washington, DC: The Center for Law and Social Policy.

be used. Granting program managers and service providers authority over programs may be a powerful incentive to use funds productively.

In recent years, different state education and human service departments and agencies have increasingly explored methods for exchanging flexibility for performance. Some states, for example, are allowing local governments and agencies to blend or decategorize funds in exchange for meeting performance targets.

The federal government has also endorsed the notion of exchanging flexibility for performance. Federal waivers provide an excellent example. While states must abide by federal program guidelines in order to receive funds, the federal government can choose to waive some of these rules under certain conditions. For example, the Social Security Act allows the federal government to give states the flexibility to demonstrate alternative approaches to providing support or medical care for low-income individuals, including children with families.

In recent years, the federal government has increasingly taken advantage of this option, granting waivers to states and local communities from federal program guidelines for both welfare and Medicaid. Prior to the passage of new federal welfare legislation, many states and communities took advantage of this option. While the new legislation gives states considerably more flexibility in administering welfare, some states may elect to continue their experiments. Regardless of whether these experiments continue, they provide an excellent example for state and local leaders of a method for exchanging flexibility for performance.

KENTUCKY PUBLIC EDUCATION: SYSTEM-WIDE ALIGNMENT OF INCENTIVES TO ACHIEVE RESULTS

History

- In response to a 1989 state supreme court ruling that its school system was unconstitutional, Kentucky public education was redesigned to achieve more equity of outcomes.
- Inequity was *not defined as uneven resources* going into schools, but rather as *uneven skills and capacities of students coming out* of the schools.

State Action

- Kentucky's 1990 Education Reform Act establishes educational performance outcomes for all students, and requires schools to focus their energies on helping students achieve them.
- Every Kentucky school sets goals for student learning gains and has its own authority to make key decisions.
- Student performance assessments, focusing on achievement of knowledge and skills, determine progress.
- School councils, which include teachers and parents, guide the decisionmaking process.

Incentives and Sanctions

- Schools that exceed their goals receive financial bonuses. Principals and teachers determine how bonus money is used.
- The Act also establishes sanctions for poor-performing schools.
- However, the Kentucky legislature believes that sanctions are premature. More evidence needs to be gathered about causes and effects of poor performance in education.

▼ *Allow School Site-Based Management*

In education, some forms of site-based or school-based management provide flexibility in exchange for performance. Site-based management involves transferring considerable decisionmaking authority from central school districts to the individual sites or schools. Again, the motivating idea is that increased authority, particularly over the school's budget, will motivate teachers, principals, librarians, and others to achieve results.

Ideally, a site-based management system provides individual schools with lump-sum budgets. Such a program provides incentives for teachers, administrators, and parents to work together to ensure that children meet high standards. School faculty, together with parents, can develop strategic performance plans. They can allocate funds in ways that might stimulate children to master more challenging material than they might under a more centralized service delivery approach. The school leadership, not central administration, would also have the authority to recruit, train, and evaluate personnel.

▼ Option 4: Establish Partnerships for Performance

Performance partnerships require multiple parties to commit to achieving common outcomes. Under performance partnerships, the parties are collectively accountable for meeting performance targets. Like a business partnership, each party invests so that the enterprise can succeed.

Oregon is well along in pioneering partnerships for performance—starting with state and local efforts through the *Oregon Benchmarks* initiative. The statewide initiative focuses on results. Oregonians have established a long-range vision and set priorities. (See Chapter 6: *Building Support for Finance Reform*, for information on setting benchmarks through the "Goals Process.") Now local, county, and state governments are allocating resources and designing services to help achieve desired results, and they are measuring progress.

Oregon Benchmarks set targets for long-term and immediate goals in a set of activities as wide ranging as ecosystem protection, urban mobility, and industrial diversification. Human investment benchmarks focus on such results as reduced pregnancy, diminished crime and recidivism, lower unemployment, higher per capita income, greater early-childhood immunization, and stronger student achievement.

Communities, non-profit organizations, businesses, and civic groups are all involved in setting and achieving the benchmarks. State agencies, sub-state governments, and non-government entities have begun to replace an intergovernmental system entangled by the knots of mutual distrust with one that is aligned by a mutual commitment to results. This experiment in governance shows great promise, especially with the recent addition of the federal government as a new partner.

In 1994, Oregon and the federal government committed themselves to testing a new kind of intergovernmental relationship—one driven by results. The *Oregon Option* is testing the proposition that multiple levels of government can align their efforts in order to help achieve results that matter to people. Under the new arrangements, local, county, state, and federal officials are experimenting with new intergovernmental relationships that could improve Oregon's chance of making progress on its priorities.

[illegible]

A FEDERAL – STATE PERFORMANCE PARTNERSHIP: THE OREGON OPTION

Multiple levels of government and multiple entities within each level of government:

- Agree to cooperate and work together.
- Reach consensus on desired benchmarks or outcomes, including those in education and other children's services.
- Share responsibility for achieving these outcomes.

STRATEGY 2: GIVE FAMILIES WITH CHILDREN MORE CONTROL OVER FINANCING

Earlier discussion of incentives focused primarily on restructuring incentives for those who lead or work in education and human service systems, since those who supply services are critical in improving results, financing strategies, and judging performance. However, an alternative approach is to shift more authority to the users or customers of the service—the children and families who receive these services. These demand-side approaches restructure incentives for program administrators and direct service providers by empowering the service recipients to judge the effectiveness of service delivery.

A demand-side approach provides funds directly to service recipients to obtain the needed supports or services, rather than to service providers to offer services. Demand-side approaches assume that citizens should be able to choose from a range of service options when receiving public sector services, just as they would when purchasing non-publicly provided services or goods, such as food or clothing. They are built on the premise that citizens can choose the best service or good to meet their needs.

To be effective, demand-side approaches must restructure the way that services are provided. Multiple service providers must compete for people's business. Those services that best meet the demand ought to thrive. Ideally, those that are failing to provide quality services go out of business.

While many express concern that demand-side approaches do not allow funds to be as tightly monitored as when supports or services are provided directly, such approaches have been used to help many Americans. The GI Bill enabled thousands of World War II veterans to choose among the nation's finest colleges and universities. Section 8 housing vouchers enable low-income individuals to choose apartments other than those in public housing projects. And food stamps ensure adequate nutrition by permitting low-income families to shop at their favorite market.

Because of their potential promise, state and local policymakers are exploring various options for giving families with children more control over financing. Several demand-side options worth investigating are: (1) more demand-driven education systems; (2) demand-side approaches to encouraging self-sufficient families; and (3) tax incentives to encourage the use of various services.

▼ Option 1: Create More Demand-Driven Education Systems

Demand-driven education systems seek to empower parents and families by allowing them greater latitude in choosing the appropriate school or curriculum for their children.

Demand-driven education systems seek to empower parents and families by allowing them greater latitude in choosing the appropriate school or curriculum for their children. As with other demand-side initiatives, this option allows children and families to determine which programs are most suited to their needs and interests. Experimentation is widespread, and evidence of results is accumulating through such initiatives as charter schools and educational choice.

▼ *Authorize Charter Schools*

State and local leaders interested in realigning incentives in education to empower families with children can consider funding charter schools. *Charter schools* are public schools that receive a "charter" from the state to operate outside the control of the local school district. Charter school proponents believe that charter schools empower families with the power to choose an educational alternative other than that offered by the local school district.

Charter schools are often organized by teachers, parents, and community groups—or some combination thereof—and usually involve a special academic focus or theme that distinguishes them from other public schools. Charter schools may be designed to emphasize certain subjects, such as math and science or the fine arts; to implement instructional approaches like Montessori, back-to-basics, or school-to-work programs; or to target groups of students such as pregnant teens or disruptive students. They frequently have considerable autonomy over personnel, management, and budgeting, but are still subject to health, safety, and civil rights regulations, as well as basic standards regarding curriculum, student assessment, financial reporting, and other provisions. Sometimes charter schools remain under the control of the local school board (even though many of the school board's regulations are waived), but many states authorize other institutions, such as local universities and specially appointed panels, to grant charters as a way of generating competition and fostering innovation.

The challenge for states and school districts sponsoring charter schools is to ensure that charter schools remain accountable for high performance as they gain freedom from many regulations and oversight provisions. Almost all charter school programs require the new schools to set performance measures—usually reflecting factors such as test scores, grades, graduation rates, promotion rates, and college attendance rates—as a precondition to the granting of a charter. Another vital challenge is to ensure that charter schools meet the needs of a wide range of students and that all students—not just more advantaged and high-achieving students—have an equal chance for a slot in a charter school. Finally, financing provisions, both for operating and fixed costs, are critical. Charter schools should receive the same per capita funding for operations as other public schools that serve similar students, although start-up grants are often necessary to enable charter schools to buy, lease, or renovate facilities.

▼ *Offer Families Choices Among Different Schools and Curricula*

Educational choice initiatives allow parents and students to choose among options beyond their neighborhood school. Schools participating in a choice plan typically are neighborhood schools that are operated by the local school district, although some choice plans allow students to attend private schools. Thus, these plans encourage better results, not by allowing students to attend schools with radically different administrative structures, but rather by allowing them to attend other schools that may have a stronger faculty, more efficient management, or an emphasis on instructional material that is more suited to a child's interests or needs.

The types of options and choices open to children and families vary considerably, depending on the particular program. Some choice programs, like Minnesota's program, allow students to select schools statewide regardless of location. Some choice programs, such as New York's East Harlem program, restrict a student's choice of schools to those within his or her district. Others, such as Milwaukee's program, allow parents and students to choose among public or private schools.

The dynamics of school choice can be very powerful. They shift decision and management responsibilities from central administrators to parents and teachers. They provide a strong incentive for teachers and others to better educate students and maintain the satisfaction of students and parents. And they encourage educators to customize their courses to their students.

When considering this option, however, state and local decisionmakers need to be aware of many of the difficulties with implementation. For a program to be effective, parents and students must have ample information about their different options, including details about the performance of each school. Then they must use this data to make informed enrollment decisions. Many parents simply remain unaware of their options, despite the best efforts of school or district administrators to communicate this information. Research consistently shows that better-educated and higher-income

STRATEGY 2: GIVE FAMILIES WITH CHILDREN MORE CONTROL OVER FINANCING

parents are more likely to participate in a choice plan than are less-educated and low-income parents.

Even when parents are well informed, some evidence indicates that many families choose schools based on a number of factors, only one of which is performance. Transportation, convenience, and community ties are also factors in the decisionmaking processes of many.

Other critical variables to consider are the *nature* and *extent* of the choice made possible under the plan. In many public school choice plans, schools and school districts can choose whether to accept students from other neighborhoods, which limits the scope of choice. In evaluating a choice plan, policymakers should ask, "How many slots are likely to be available? In which schools? For which students? How many students will private schools admit, and what kind of admission criteria will they use?"

Financial incentives will also shape a choice program. Determining the level of resources that will shift from school to school—or from school district to school district—is one of the most critical choices for state and local leaders establishing such plans. The size of the voucher must be large enough to encourage schools to accept new students under a choice program, yet, if it is too large, the quality of education at schools that lose students may plummet even more. Policymakers should also consider increasing the voucher for disadvantaged, limited-English proficient, and disabled students who may cost more to educate. Finally, policymakers must ensure that schools of choice are held accountable for student performance.

In addition, for school choice programs to provide true incentives to teachers, principals, and other school personnel to achieve results, other factors must change as well. School staff must have real authority to innovate and allocate resources. They must realize gains from their participation through financial bonuses, recognition awards, or professional advancement. And consequences for poorly performing schools must be explicit, real, and fair, in order to force out poor-performing teachers or schools.

AN EXAMPLE OF SCHOOL CHOICE: THE MILWAUKEE PLAN

The Milwaukee Parental Choice Program permits financially disadvantaged students to choose between public and private schools.

Students may elect to attend one of the participating private nonsectarian schools or their local neighborhood public schools.

Participation in the program is limited to approximately 1,500 students of the roughly 97,000 city schoolchildren.

When a low-income student chooses a private school, that school receives the state's portion of educational funding—approximately $3,000.

The Milwaukee experience is still new. Proponents of public funding for private school enrollment point to large increases in parental satisfaction among those choosing a private school. Opponents, however, stress that studies by the University of Wisconsin/Madison show no gains in test scores by students participating in Milwaukee's private school choice plan.

▼ Option 2: Encourage Self-Sufficient Families through Demand-Driven Approaches

Another emerging *demand-side* idea enables families on welfare to use public funds to accumulate assets, not simply to purchase services. The current welfare system provides cash assistance to poor families with children, but does not allow families to accumulate assets above a certain limit. While such a system may provide temporary assistance to those in need, many feel that it does not encourage essential activities for moving poor families out of poverty: investing and accumulating assets.

▼ *Promote Plans That Encourage Savings*

Many state and local policymakers concerned with children and families are investigating demand-driven approaches for promoting self-sufficient families. Among the most innovative ideas currently being tested is an *individual development account (IDA)*. Similar in concept to an individual retirement account (IRA), an IDA is a long-term individual savings account dedicated to funding human investment activities.

IDAs vest control of the service system in the hands of intended beneficiaries by allowing welfare recipients to choose between buying current goods and services or investing funds in a range of investment options. Unlike many of the options discussed in this chapter, IDAs work by altering the incentives for families and children, rather than those affecting service providers.

The differences between IDAs and IRAs reflect their different policy objectives. IRAs shelter funds from current taxes to encourage working adults to save for retirement. IDAs, on the other hand, shelter funds from welfare asset limits, encouraging families on welfare to save for a more self-sufficient lifestyle. Just as IRA funds may only be used in certain conditions without penalties, IDA funds may be used only for particular purposes. Families may use funds for high-return personal investments such as attending college, starting a business, or buying a first home.

The Corporation for Enterprise Development has worked with several communities across the nation to pilot this concept. Tupelo, Mississippi; Bozeman, Montana; and Chicago, Illinois, are among the communities currently experimenting with the concept. In Indianapolis, Indiana, Eastside Community Investments (ECI), a community-based non-profit economic development corporation, also operates an IDA program to promote community investment in human and physical capital. ECI matches individuals' savings deposits, which can be used only for postsecondary education, long-term job training, the purchase of a home, or the starting of a business. Local organizations and businesses—including community development corporations, development banks, private businesses, housing groups, and government—have all been actively involved in using IDAs to encourage self sufficiency.

▼ Option 3: Create Efficient Incentives through the Tax System

Tax incentives are yet another option for state and local policymakers to improve service delivery arrangements. *Targeted tax incentives* also are known as tax expenditures because they provide indirect public expenditures for particular activities by providing preferential treatment to individuals, households, or corporations through the tax system.

As noted in Chapter 3, tax expenditures are similar to direct expenditures in that they reduce government revenue and they provide direct benefits. Tax expenditures may take a variety of forms. They include mechanisms that reduce government revenues by reducing the tax base (e.g., through a child care tax credit) or by varying the tax rate (e.g., by imposing lower tax rates to encourage economic development in economically distressed areas).

STRATEGY 2: GIVE FAMILIES WITH CHILDREN MORE CONTROL OVER FINANCING

Tax incentives targeted to children and families have several advantages as methods for delivering services. They:

- Permit children and their families to choose among different providers when purchasing a given service. For example, the child care tax credit not only allows families to receive subsidized child care through reductions in their federal income tax, but also permits them to choose their preferred child care provider rather than requiring families to use a public or government-approved provider.
- Allow all eligible families or individuals to claim benefits without stigma.
- May also be cheaper to administer than a comparable direct-outlay program.
- Can be constructed to be income contingent when administered through the income tax system.

The downside to tax expenditures is they are not typically subject to the same budget review processes as direct expenditures, as noted in Chapter 3: B*udgeting Better*. The costs of encouraging programs for children and families through the tax system can be significant. This is particularly true because tax expenditures represent a form of entitlement, allowing all eligible recipients to receive benefits. See Chapter 2: *Generating Revenue* for a fuller discussion of the implications for revenue generation of narrowing tax bases through tax expenditures.

SUMMARY

This chapter has described various approaches for building solid government finance structures that enable decisionmakers to allocate and use public money efficiently and productively. At the heart of these public financing innovations is a vision of lean, effective governance that helps produce well-educated, healthy, and safe children. To realize this objective, careful attention must be paid to how the people who deliver and use services can direct resources to their most productive uses. In particular, state and local leader must align incentives to:

- Help teachers, child care providers, school nurses and other service providers focus on assisting the end users—children and families;
- Encourage service providers, program administrators, and others to reduce transaction time, improve quality, and reduce cost; and
- Provide sufficient flexibility for educators, health care personnel, and human service providers to do their jobs well.

This chapter has focused on some of the ways that finance arrangements can, if properly constructed, promote the achievement of results. When restructuring finance systems to ensure that incentives are well aligned, state and local leaders can work to link pay to performance, instituting merit pay or pay-for-performance schemes. Contracts between service providers—whether they are public sector or private sector employees—and state or local agencies can also be used to improve program performance.

In addition to monetary incentives, states and communities can experiment with providing non-monetary incentives to improve performance. One powerful incentive that many areas are testing is granting service providers increased flexibility in administering programs. New partnerships between various government agencies and/or local organizations which emphasize performance by clearly specifying common performance targets and objectives are also changing the way that education, health, and human services are delivered.

Other important options exist for restructuring incentives—those which give families more control over financing. These options vest families with additional control over what types of services they receive. They include options to create more demand-driven education systems—for example, by creating charter schools or offering families more options in selecting schools and coursework. They also include individual development accounts, which encourage families to become self-sufficient by creating positive incentives for saving. Finally, states and communities can consider methods to provide indirect assistance through targeted tax incentives, such as child care tax credits.

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Who To Contact For More Information

Center on Budget and Policy Priorities, 820 First Street, NE, Suite 510, Washington, DC 20002, (202) 408-1080.

Center for School Change. 234 Humphrey Institute. 301 19th Ave., South, Minneapolis, MN 55455, (612) 626-1834..

Consortium for Policy Research in Education. Graduate School of Education, University of Pennsylvania, 3440 Market Street, Suite 560, Philadelphia, PA 19104-3325, (215) 573-0700.

Education Commission of the States, 707 17th Street, Suite 1700, Denver, CO 80202-3427, (303) 299-3600.

Federation of Tax Administrators, 444 N. Capitol Street, NW, Suite 348, Washington, DC 20001, (202) 624-5891.

Reinventing Government Network, 275 E. 4th Street, Suite 710, St. Paul, MN 55101, (612) 223-8371.

Southern Regional Education Board, 592 Tenth Street, Atlanta, GA 30318, (404) 875-9211.

The Reason Foundation, 3415 S. Sepulveda Blvd., Suite 400, Los Angeles, CA 90034, (310) 391-2245.

For More Information on Examples Provided in the Text

City of Indianapolis, Office of the Mayor, City-County Building, 200 E. Washington, Indianapolis, IN 46204, (317) 327-4622.

Corporation for Enterprise Development, 777 North Capitol Street, NE, Suite 410, Washington, DC 20002, (202) 408-9788.

Eastside Community Investments, 26 North Arsenal Avenue, Indianapolis, IN 46201, (317) 637-7581.

Oregon Progress Board, 775 Summer Street, NE, Salem, OR 97310, (503) 986-0039.

Milwaukee Parental Choice Program, Wisconsin Department of Public Instruction, 125 S. Webster Street, P.O. Box 7841, Madison, WI 53707-7841, (608) 266-2853.

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BACKGROUND: THE DUAL ROLES OF POLITICAL SUPPORT AND PUBLIC ENGAGEMENT 121

Support from the public and its leaders complement each other to ensure strong, long-lasting support for finance system changes.

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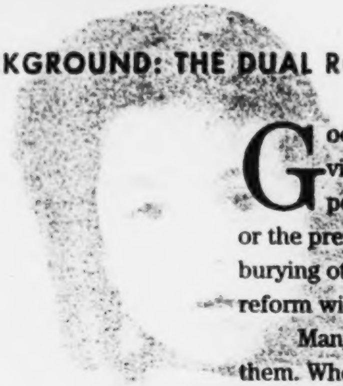
BACKGROUND: THE DUAL ROLES OF POLITICAL SUPPORT AND PUBLIC ENGAGEMENT



Good ideas for reforming finance systems for education and other children's services don't always fly; sometimes, unfortunately, the most inappropriate or poorly conceived notions spread like wildfire. Maybe it is serendipity, timing, or the prevailing public mood that brings initial success to some reforms, while burying others in obscurity. Maybe it is good salesmanship or a perception that the reform will be easy, painless, and effective.

Many times, positive reforms succeed because leaders and citizens help to create them. Whether the impetus for change grows from within government or outside it, lasting support comes when elected officials, community leaders, and the general public have good information and time to consider and select options they are willing to stand by and implement.

The processes of building political support and engaging the public often have been conceived as separate and distinct. Yet research and experience underscore the need for reform advocates to strike a delicate balance between the directions charted by leaders, and the priorities of an informed public.

OVERVIEW

Chapter 6, *Building Support for Finance Reform*, presents strategies for building the necessary support to improve finance systems for education and other children's services. The chapter begins by emphasizing the importance of garnering both political and public commitments. It then presents a series of interrelated strategies to solidify support. To begin an initiative, those seeking to improve finance systems should first lay the groundwork by clarifying the purpose of reform; understanding the political, economic, and other environmental factors likely to influence the reform effort; and building an initiating team. The chapter suggests several approaches to garner the support of elected political leaders and increase public knowledge and understanding, including finding political champions and using the mass media and new electronic information technologies to communicate to the public. The chapter then outlines methods to involve the public in selecting the preferred solution: Framing the issues effectively and creating opportunities for public deliberation are important methods for accomplishing this task. The chapter concludes by suggesting methods to crystallize commitment to change, including publicizing consensus and holding celebratory gatherings.

Political leaders can bring visibility to a pressing problem and help to enact legislation, change procedures and policies, or mobilize resources for finance system change. They can solicit new ideas and proposals from their staff for improving revenue generation, budgeting and other finance mechanisms. And political leaders who champion the need for reform frequently can play instrumental roles in building the support needed for change.

While political leadership is crucial, so, too, is the involvement of an active public. Many voters, taxpayers, and parents consider methods of finance to be complicated and obscure. Similarly, information about how finance systems can be improved is often dense and hard to access. Simplifying the issues presented to the public, however, can result in perilously weak support. Leaders have to know where the public is coming from, where people stand now, and where they are heading. And the public must have an opportunity to weigh the choices and tradeoffs before they commit themselves to reform.

Efforts aimed at engagement, rather than persuasion, can also potentially reduce voter frustration. Recent research has found that "citizens lament the fragmentation and sense of isolation that seems to pervade the way we think about and discuss public concerns."[1] Reform efforts that do not engage the public may result in short-term permission for a certain course of action, but rarely in public commitment and long-term support.

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BACKGROUND: THE DUAL ROLES OF POLITICAL SUPPORT AND PUBLIC ENGAGEMENT

A large percentage of the population believes that government is inefficient and ineffective in providing the services they value most, including education and other children's services. Involving the public in finance reform—linked to performance management and results-based accountability—can show good faith on the part of government to improve productivity and quality. In addition, in a no-growth or declining-resource situation, public consensus becomes increasingly important in making decisions about which services will be provided and why, and how they will be financed.

Rather than trying to sell political leaders and the public on specific initiatives, wise advocates for reforming finance systems for education and other children's services will work to build the public's ownership in the proposed options for reform. In particular, they will endeavor to increase knowledge of the need for improving the system, thereby laying a foundation for later decisions on which options or strategies deserve their energies and attention.

Those who seek to restructure the finance and delivery of services to children and families face two distinct tasks: (1) to adequately involve the public and political leaders so that they are equipped to implement and maintain change, and (2) to secure enough support from political leaders to make change possible.

Recent research documents a multi-stage, interactive process for building support for change (see accompanying box). Building on this research, the remainder of this chapter identifies a series of interrelated strategies that should be launched, revisited, refreshed, and continually refined to achieve these two goals. They are:

- Lay the groundwork for finance reform;
- Garner political support;
- Increase public knowledge and understanding of the issues;
- Create opportunities for public deliberation; and
- Crystallize commitment to change.

Those who seek reform should keep in mind that, while all of these elements are critical, the strategies presented in this chapter do not necessarily have to be pursued in the order they are discussed (except for steps that lay the groundwork for finance reform, which generally precede other strategies). For example, garnering political support is not an essential step to increase public understanding of the issue. In fact, the public may be more ready to support changes than the elected leadership. Thus, those who seek to improve finance systems for education and other children's services need to recognize the importance of a multifaceted approach, assess which of the strategies have been pursued, and evaluate which strategies still need to be tackled.

STRATEGY 1: LAY THE GROUNDWORK FOR FINANCE REFORM

Moving from the identification of an issue to strong support and eventual action involves multiple stages. Accordingly, state and local leaders seeking finance reform must first lay the initial groundwork for change before garnering support from political leaders or the public, or identifying and selecting the preferred course of action.

The public and its leaders must understand why reform is urgently needed and how it will improve education, health, or other children's services. Those seeking change need to be aware of the policy environment—for example, how economic,

[redacted]

[redacted]

HOW OPINIONS LEAD TO ACTION

Why do public opinion polls show strong support for some types of reform? Why do other issues receive little media attention or political discussion? Recent research points to a multi-stage, interactive process involving an ongoing dialogue between the public and its leaders that moves public issues to the top of the public's agenda. In particular, as the public struggles to grasp and resolve an issue, they go through the following distinct stages:

Stage 1: Dawning Awareness

The public becomes aware of an issue and the need for change through media coverage, the work of advocacy groups, and the actions of state and local leaders. But they are not familiar with specific proposals for resolution.

Stage 2: Greater Urgency

Public consciousness of the issue increases, and taxpayers and citizens begin to see how the issue affects them personally. Heightened awareness of the need for change leads to a more urgent call for change by the public.

Stage 3: Searching for Answers

Eager to find ways to improve the situation, the public focuses on alternatives crafted by experts. Policymakers seeking to evaluate support for different proposals will find opinion polls confusing during this stage, because the public's understanding of the issue has not yet fully matured.

Stage 4: Resistance and Wishful Thinking

The public is reluctant to make the tradeoffs that come from choosing a specific course of action—which makes the situation ripe for pandering. High levels of resistance can turn insurmountable if people feel excluded from the decision-making process that governs their daily lives.

Stage 5: Weighing the Choices

People consider the pros and cons of alternative solutions and wrestle with any value conflicts that choice entails. Policymakers need to present a range of choices and sufficient opportunities for deliberation during this stage.

Stage 6: Intellectual Acceptance

People make up their minds, but don't yet commit with their hearts. Fuzzy thinking gives way as they reconcile inconsistencies and grasp the consequences of their choices. State and local leaders need to interpret polls carefully, because people may not yet be willing to act on their changes in attitude.

Stage 7: Emotional Acceptance

Over time, individuals confront their ambivalence towards the selected course of action, accommodate unwelcome realities associated with the choice, and overcome the urge to procrastinate. They are ready to act upon the moral judgments they make.

Source: The Public Agenda Foundation

fiscal, or political factors may help or hinder reform efforts. And reform leaders need to consult with key state and community leaders to ascertain their sense of the need for finance reform and their willingness to support it.

In short, laying the groundwork for finance reform is critical to garnering the political and public support needed for change. But, depending on the particular circumstances surrounding the reform effort, some of the groundwork may have already been laid. For example, external events or actions may have already served as a catalyst for reform, focusing community attention on the need for change. In many states or communities, for instance, court orders mandating finance system changes before schools can open or classes can resume have prompted action.

To lay the groundwork for finance reform, those seeking to improve education and other children's services should: (1) clarify the need for change; (2) explore the political, economic, and other environmental conditions; and (3) identify and involve initial stakeholders.

▼ Approach 1: Clarify the Purpose of Finance Reform

The first task facing those wishing to reform finance systems for education, health, and human services is to define the need for improvement in ways that make it easy for those with a stake in the outcome to understand. Key questions that should be addressed include: Why is finance reform necessary? What are the results to achieve? How will reform improve the delivery of education and other children's services? What impacts will proposed changes have on those with vested interests?

In defining the need for change, it is important to think ahead, anticipating how to characterize the benefits of changing finance systems for each of the different kinds of stakeholders—including service providers, children, and their families, as well as the taxpayers who foot the bill. A particularly important task is showing how finance reform for education and other children's services furthers the agendas of political leaders.

It is often tempting to move hastily through the definition process. Yet clarifying the need for reform lays the foundation for the appreciable work to come. By clarifying the purpose of the reform—whether it is to improve revenue generation or budget more efficiently— policymakers can move with greater confidence toward a common vision for change. Clarifying the need for reform can also illuminate the importance of this issue as it is juxtaposed against other issues and public concerns.

The issues surrounding finance reform are complex, but clarity is essential when communicating the need for change. To ensure that this need is clearly communicated, try to describe the problems in succinct statements from which further discussion on proposed actions can flow. Those seeking change should also use language that is easy to understand and resonates well with the priorities of stakeholders. In addition, focus on building support for enacting change—rather than support for pursuing particular reform efforts—because this support is more likely to endure.

Those concerned with finance reform for education and other children's services should also make sure to communicate their sense of the need for reform in ways that invite response. Other reasons for reform may emerge that add value or link more closely to the interests of elected and appointed officials, as well as the general public, or others with an interest in reform.

[redacted]

▼ Approach 2: Understand the Policy Environment

In laying the groundwork for reform, policymakers and child advocates must understand their state or local policy environment. Taking the time to assess the larger political, economic, and cultural climates of the state or community is particularly important. This knowledge allows reform advocates to better comprehend the potential constraints and opportunities for enacting successful finance reform.

Many organizations assess their political, economic, and contextual surroundings in order to get a fuller grasp of the conditions in which education and other children's service programs operate, and how these services fit into the bigger picture. The accompanying box highlights the key elements that a comprehensive scan would include.

As they learn more about current conditions, expectations, needs, and biases built into the social environment, those seeking to reform finance systems for education and other children's services are better able to position finance reforms in ways that appeal to governors, legislators, and key local officials. Some questions to consider when evaluating the policy environment include:

- How does finance reform for family and children's services relate to broad state or local goals enunciated by the governor or other key elected officials? How can finance reform fit into the agendas of the governor, mayor, or other elected officials?

[redacted]

LAYING THE GROUNDWORK FOR FINANCE REFORM: KEY ENVIRONMENTAL VARIABLES TO ASSESS

Various trends and forces shape the receptivity of a state or community to improvements in finance systems for education and other children's services. A working understanding of these elements—and how they are likely to influence the perception of the need for reform or the options most likely to succeed in it—can greatly assist those seeking to improve these systems. In particular, state and local leaders working to reform finance systems should review the following factors:

- **Economic Conditions.** State fiscal conditions; ability of revenue systems to sustain economic fluctuations; levels, sources, and distribution of income; and ways that services are currently financed.
- **Social Factors.** Issues related to the life, welfare, and relations of people and communities that affect the nature of family and children's services.
- **Demographic Situations.** Sizes of various population groups, urban/suburban/rural distributions, and concentrations of various age groups who affect the need for services and the ability to support them.
- **Political Conditions.** Power to enact budgets, pass legislation, and change policies and procedures–particularly as it relates to finance systems for education and other children's servcies.
- **Cultural Context.** Ways of life of groups of residents that are transmitted from one generation to another and that influence preferred services, delivery patterns, and methods of finance.
- **Historical Events.** Past events in the state or locality that have a bearing on the willingness to support finance reform.
- **Prevailing Attitudes.** Mental dispositions, feelings, or tendencies prevalent in the population that will influence the public reaction to finance reform.
- **Local Amenities.** The quality of life in the state or locality that may be influenced, either positively or negatively, by the proposed finance reform.

Source: Council of Governors' Policy Advisors, *The Policy Development Framework.*

- What groups are likely to support finance reform for family and children's services? Which political leaders are likely to resist such reform?
- At what time point in their terms of office are key officials from whom you seek support? How might their length of time in office or the likelihood of their reelection affect your chances of success?
- What is the economic climate of the state or locality, and how does finance reform play in that climate? How can economic conditions help or hurt proposed finance reforms?
- What are the cultural values of the geopolitical area, and how will finance reform resonate? How can these values be used to leverage support for finance reform?

Answers to these questions will help when crafting messages that resonate well with the public and its leaders, developing strategies to increase political support, and elevating public understanding.

▼ Approach 3: Identify and Involve Primary Stakeholders

It is hard to advance any policy reform—and virtually impossible to build and maintain its support in political circles and the larger public arena—without true participation from myriads of individuals and organizations that have stakes in the outcome. The unique knowledge and contributions of these groups can also add value.

Those determined to build support for finance reform by actively engaging the many groups with an interest in children's services should endeavor to broaden the community of stakeholders and to increase their level of involvement. At the outset of a reform, however, support and advice from a core team of leaders—both inside and outside government—can be instrumental in charting the general direction of reform. Such leaders can serve as a valuable sounding board (for example, by providing extremely helpful input on creating the message on the need for reform). Use the following guidelines to think about likely candidates when forming this initiating team:

The task here is to identify a core group of political leaders and key supporters who will endorse some type of finance reform—not to pit one group against another.

- *Think about political stakeholders.* Involving elected officials as members of the initiating team can have generous payoffs. Political stakeholders often have a good sense of the areas that are most in need of reform, and also those that will take substantial time and resources to change. And political stakeholders can eventually help to rally support for the needed change. When identifying likely candidates for the initiating team, ask the following types of questions: Which executive branch officials have a stake in the outcome? Which legislative leaders? How about local leaders, such as mayors, city council members, county executives, or county commissioners?
- *Include other primary stakeholders,* such as influential business or interest group leaders who might be natural allies, and who can work with other members of the initiating team. Remember, the task here is to identify a core group of political leaders and key supporters who will endorse some type of finance reform—not to pit one group against another.
- *Identify other stakeholders* in the process. Ask questions such as: Who are the natural allies of finance reform? Who are the ones likely to oppose it? Consider as candidates for the initiating team: the managers and administrators of agencies that provide services to children and families; the families or beneficiaries of services;

and the taxpayers who make financial investments in public services possible. Keep in mind that inclusiveness is not just a goal, but a requirement, for success. It will not be possible to sustain reforms in education or any other system serving children and families without broad-based ownership in the reform efforts.

- *Look also to the media, an important and frequently overlooked group of stakeholders.* The media are often approached at the end of the process in order to generate news coverage when an initiative is ready to be unveiled, instead of at the outset. Syndicated columnists, editorial writers, and media decisionmakers may have championed similar reforms in the past or been instrumental in swaying public opinion. Because members of the media often have their fingers on the public pulse, they can be valuable members of the initiating team.

Once the members of the initiating team have been identified, work with them to communicate a sense of the need for reform. This may require those seeking change to be sensitive to the current political, fiscal, or economic environment, and for them to underscore how finance system changes will address the specific concerns of different leaders and their constituencies. Although this process may be time-consuming, it will have generous payoffs throughout the process of building public and political support, by laying a solid foundation for change. (For additional guidance on designing messages, see the section on tailoring the message in this chapter.)

STRATEGY 2: GARNER POLITICAL SUPPORT

Governors, legislators, mayors, city council members, and other key political leaders can play a pivotal role in advancing reforms to improve finance systems for children's services. They can help to draw attention to the need for reform, build support for particular options, mobilize their constituencies, and enlist the support of other state or community leaders.

Thus, it is often easier to advance finance reform for education and other children's services with political endorsements, particularly across various sectors of government. A host of interrelated reasons underscores the need to secure solid political commitments, including:

- *Solid political endorsements can facilitate change.* Service providers, program administrators, and parents are often wary of change. Many are concerned that even well-meaning changes will adversely affect them or their children. Strong leadership can help to overcome some of these hurdles. Political support can also help remove barriers that were originally intended as protections against whimsical reforms or malicious politics, but which now serve as impediments to delivering and financing quality education or other children's services.
- *Well-informed political leaders make better allies.* Whether the prediction is for stormy political weather or clear skies, effective leaders like to be well prepared. Working with political leaders to ensure that they have the opportunities to lead popular efforts to bring about finance system change—rather than be surprised by them—may avoid making unnecessary enemies and prove useful when looking for support to implement reform.
- *Effective public engagement, a "messy" and lengthy process, is often fostered through political commitment and leadership.* People inside and outside of government care about proposed changes in the financing of family and children's

services. But not everyone is ready or able to help define the issue, plan for change, and mobilize action. Some, especially government officials, may find it extremely risky (if not foolhardy) to begin a large process of public engagement without the support of key elected officials. Political leaders are well positioned to launch substantive public discussions, create incentives for participation, and sustain productive deliberations for people to evaluate their options and settle on a course of responsible action.

When garnering political support for changes in the ways that state and local governments generate revenue, budget their resources, or structure partnerships between government and the public sector, two approaches should be followed: (1) find political champions, and (2) pursue actions to maintain political will.

▼ Approach 1: Find Political Champions

Political champions are the highly visible leaders who can launch and sustain efforts to reform the finance and delivery of family and children's services. Working with political leaders to secure a prominent spot on their agenda can have generous rewards for finance reform efforts. It can increase the attention of other leaders, key

A KEY ELEMENT IN BUILDING PUBLIC AND POLITICAL SUPPORT: UNDERSTAND THE NATURE OF CHANGE

Use Information on the Nature of Change ...

Building support for any type of change is not a linear process. It depends on rather subjective elements of human nature—a fact well known to professional marketers who carefully study the nature of change. Market research shows that:

- Fifteen percent of people accept a new product, service, or idea "quickly."
- Seventy-five percent try it out "after others like it."
- And 10 percent "never" embrace something new.

To Craft an Efficient Strategy for Building Support

Of course, building support to change public policy is not the same as earning consumer commitment to purchase a new product or service. But there are important implications for policymakers and reform advocates to consider. In particular,

- Concentrate on gaining the involvement of the 15 percent of people who are typically open to new ideas—and ask them to help involve the other 75 percent.
- Don't ignore the 10 percent who are unlikely to support finance reform for family and children's services. Otherwise, they may become actively opposed to efforts to improve finance systems and "compete" for the middle 75 percent.
- Try not to get bogged down responding to unproductive, negative behavior from the 10 percent who may actively oppose reform—or you may be unable to adequately engage the majority who are receptive to new ideas.

Source: National Education Goals Panel, "Guide to Getting Out Your Message," *Community Action Toolkit: A Do It Yourself Kit for Education Renewal*, p. 9.

BUILDING COMMITMENT FOR CHANGE: MISSISSIPPI'S EXPERIENCE

In the early 1980s, Governor Winter of Mississippi recognized the need for widespread, fundamental education reform. He became the prime champion of the cause and, with a key group of policymakers and advisors, he conceived a broad-based strategy to build support and commitment to change in education.

The Governor's team conducted hundreds of personal interviews with opinion leaders across the state, explaining the need for reform and soliciting their involvement. The team paid special attention to the legislature, where individual interviews with legislators were supplemented with group meetings among key committees.

The Governor personally solicited the participation of important legislative and business leaders—harnessing their energies as a strong cadre of primary stakeholders to advance education reform.

Among the results achieved, the Governor brought policymaking out of the "back room," achieved significant goals for children, and set a national precedent for engaging the public in shaping reform.

decisionmakers, and the general public on the importance of reform. Winning support and backing from political leaders can also help to pass legislation, remove regulatory and other administrative barriers, and eventually mobilize financial, human, and other resources to enact change.

Those seeking reform should tap stakeholders on the initiating team to help secure political champions within the executive and legislative branches, as well as other potential supporters. Keep in mind that different champions may be needed at various points in the process of building support.

When selecting political leaders to champion a reform, ask the same types of questions posed when looking for leadership to be involved in the initiating team: Who among the primary stakeholders has offered exceptionally strong support for children's issues in the past? Who has a successful track record when it comes to earning trust at the top? Who has the ear of the governor or other key policymakers? These are the people to enlist in a campaign to earn commitment at the highest appropriate levels of government.

The logical political champions will vary depending on the type of reform sought. For example, those attempting to modernize state revenue systems in order to improve support services for children and families might consider the governor or state legislators as natural allies. Or, if reform is focused on delivering local services more efficiently, advocates might seek the leadership and assistance of the mayor, city council members, county executives, or county commissioners. Particularly with the evolution of federal block grants and divestiture policies, local officials are likely to have increasingly central roles and responsibilities in finance reform for children's services.

When securing support from political leaders, those seeking to improve finance systems for education and other children's services should not jump to any conclusion about the exact nature of the reform. Rather, try to seek out champions who recognize the need to change and who are willing to engage in a public process to develop the precise content of the reform. This may be tricky! Political leaders are usually good at persuading people to their point of view, not necessarily at taking them through a process of deliberation. Thus, those seeking change should help political leaders focus on the need for reform and the potential political payoff, as well as the economic and social benefits, of engaging the public in developing a specific reform package to support.

▼ Approach 2: Maintain Political Will

As those interested in improving finance systems to better serve children and their families begin to garner political support for reforming finance systems, they will need to think about strategies to maintain political will. Once political leaders are made aware of the need for change, those seeking finance reform will need to work to ensure that the issue receives the continued attention of political leaders. Whether dealing with political leaders or the public at large, it is important to remember that people rarely take earnest action until they are committed to an issue. And they rarely make commitments without adequate information and opportunities to be involved.

Thus, policymakers and advocates seeking political endorsements should strive to keep open the process of identifying the need for change and enacting reforms. They should also take advantage of different chances to inform and involve stakeholders as plans develop to ensure that they remain engaged throughout the process.

Constructing these strategies requires attention to issues such as the timing of the reform proposal's introduction, the packaging of the proposals, and the link to other social and economic goals. In particular, those seeking to maintain political support for finance reform should:

- *Package reforms so they make sense.* To the extent possible, emphasize the common benefits that reforming finance systems for education and other children's services will have for service providers, beneficiaries, elected officials, business leaders, advocates, and other groups. Don't make people have to "connect the dots" between benefits to different groups. Political leaders will have an easier time promoting a complex finance reform strategy if they and others can clearly see how the various pieces of reform measures fit together.
- *Recognize that timing is essential.* Often, how much attention political leaders and their constituencies can focus on an issue is a matter of timing. Different windows of opportunity exist to push different initiatives to the top of the political agenda. Important windows of opportunity include: the start of a new administration; a major event, such as a far-reaching court ruling; an unexpected crisis; or a persistent problem. Take advantage of these opportunities when they present themselves.

Change will proceed more smoothly if leaders are properly prepared for the journey.

Throughout the process of working with elected leaders, it is important to communicate the message—whether it is the need for reform, the options for change under consideration, or the need for further deliberation—in an extremely straightforward manner. Typically, numerous issues and crises compete simultaneously for the attention of political leaders. Thus, experience in the states suggests some rules of the road that can help finance reform advocates to focus and capture the attention of political leaders. They include:

- *Link the issue to the priorities of political leaders.* Review the agendas of key state and local officials, such as the governor, mayor, state legislators, or city council members. Tie reform proposals for family and children's services to issues that the political leaders care about and are already invested in, such as property tax reform or economic competitiveness.
- *Underscore the benefits of involvement.* Show political leaders that finance reform can be accomplished in a timely and efficient manner. Underscore for them the political benefits of involving the public in shaping the reform package.

Remind officials of the opportunities for broad public exposure that will come throughout the public engagement process.

- *Let political leaders own good ideas.* If those seeking to improve finance systems have been successful in building the public's commitment to change, champions will emerge who want to own the process. Try to involve all those who want to participate, because endorsement by various leaders can potentially build broader public support, as well as add public credibility and heighten the awareness of the reform effort. The involvement of such leaders may also encourage greater public involvement in searching for and identifying a feasible reform strategy or option.
- *Illuminate the blind spots.* Change will proceed more smoothly if leaders are properly prepared for the journey. Above all else (except electoral defeat) political leaders loathe surprises. Making sure that leaders are not blind-sided by issues is an absolute requirement for maintaining political will. An informed political supporter is a more confident one, and can be of great help when the defenders of the status quo begin to resist the possibility of change.

When working with political leaders, don't assume a high degree of knowledge. Matters associated with the finance and delivery of family and children's services may be just as difficult for officials and leaders to understand as they are for some members of the electorate. Political leaders are not necessarily more conversant with the mechanics of financing family and children's services than the general public. While some will be, others will need to learn more about the issues if they are to actively engage the public in decisionmaking.

Once those seeking change have garnered political support and developed a promising strategy to maintain political will, they are ready to begin the much broader work of engaging the public—a process that will involve the full range of stakeholders and political leaders.

STRATEGY 3: INCREASE PUBLIC KNOWLEDGE AND UNDERSTANDING OF THE ISSUES

The success of every reform initiative is directly related to the success with which it is communicated. Simply providing information is not enough to precipitate change. Nor is it sufficient to extend token opportunities for people to become involved in reform deliberations. Educating the public is hard, time-consuming work for which no shortcuts exist. Voters, taxpayers, and families with children must have opportunities to examine the issues, learn more about the pros and cons of different proposed changes, and discuss their opinions with friends, neighbors, advisors, and experts before they make up their minds and commit to change in their hearts.

Prior to building strong public support for change, state and local leaders seeking improvements in finance systems may find the issue of finance reform much more urgent than the public. Those seeking change must carefully explore the reasons for this difference in perception carefully. This knowledge can then be taken into account when communicating the reasons for compelling change to the public, because "the shift from awareness to urgency is rarely automatic"[2] and may not develop without assistance.

Recent experience with the Medicaid program illustrates the importance of raising the public's appreciation of the urgent need for reform. Many child advocates were aware of the lack of quality health care coverage for children many years before the federal government and states expanded Medicaid coverage. Only when the public became cognizant of the acute need, however, were policies changed. The same is true of financing other services for children and families. Many people involved in the planning, delivery, and receipt of these services are concerned about the effects of the current system. Yet these concerns are not often translated into any broad call for action.

To stimulate grassroots demand for finance reform, state and local leaders should consider five approaches: (1) expanding the list of stakeholders beyond those initially involved, (2) tailoring the message to these new groups, (3) communicating the urgent need for improvements through the mass media, (4) using electronic communication technologies to increase knowledge, and (5) disseminating relevant written materials widely.

▼ Approach 1: Expand the List of Stakeholders

In order to build a broad base of support for changing finance systems, it is important to expand the list of stakeholders beyond those involved in the initiating team and the elected political leadership. State and local leaders should reach far beyond these groups of individuals to build support for the need for reform. Carefully define

STAKEHOLDERS IN FINANCE REFORM FOR EDUCATION AND OTHER CHILDREN'S SERVICES: A CHECKLIST OF LIKELY CANDIDATES

To build support for finance reform, state and local leaders should work with and through membership organizations, business interests, and community groups in order to identify and engage multiple groups of stakeholders. For starters, consider reaching out to the following individuals who have an interest in services for children and families:

___ School board members
___ Parents and PTA leaders
___ School district superintendents
___ Principals and other administrators
___ Teachers and professors
___ Students
___ Adult educators
___ Literacy advocates and trainers
___ Guidance counselors
___ Foundation executives
___ Other business organization members
___ Civic organization members
___ Ethnic organization members
___ Social service workers and leaders
___ Volunteers
___ Law enforcement professionals
___ Senior citizen centers and groups
___ Health care administrators and professionals
___ Patients and health advocates
___ Small business owners and employees
___ Corporate CEOs and managers
___ Human resource personnel
___ Community affairs personnel
___ Public agency employees and managers
___ Sales representatives
___ Media owners, reporters, and editors
___ Chamber of Commerce members
___ Organized labor
___ Members of religious organizations and congregations
___ Community center representatives
___ Child care providers
___ Job trainers
___ Museum officials
___ Librarians

the different parties and institutions that have stakes in changing the mechanism of finance. Numerous groups and individuals have direct interests in improving the finance systems that support education, health, and human services (as shown in the accompanying box).

In addition, include as potential stakeholders those who have not previously been associated with family and children's service issues, but who may have a developing interest. For example, the elderly represent an influential group who could be an enormous asset to finance reform for education and other children's services if they became aware of the benefits that such reforms can have, both for extended family members and for all taxpayers.

Although potentially time-consuming, the early identification and involvement of stakeholders is an important step in increasing public understanding of the issue. In addition, it can have important payoffs at the end of the process by ensuring widespread knowledge and support for change. State experiences with finance system reform sparked by school finance litigation illustrate this point well. A recent study found that, when crafting new school finance systems, "legal remedies were most effective in states where proposals were formulated through a grassroots deliberation process which built in a state-wide base of support for specific reform proposals."[3]

▼ Approach 2: Tailor the Message

After identifying the groups and individuals with a stake in finance reform, those seeking to improve finance systems must clearly present the issues to different target audiences—creating a unique message that sets the tone and conveys a sense of importance to each audience.

All of the speeches, interviews, meetings, reports, and other written materials associated with those advocating finance reform send specific messages—some positive, some negative, some intentional, and others unintentional—to various target audiences. Thus, it pays to invest the necessary time and effort in order to develop messages aimed at garnering specific results. Some general tips to keep in mind when working on an effective message include:

- *Understand the debate.* Study the issues carefully. Look at experiences in other states and communities. In addition to academic research, review past media coverage—particularly editorials and articles about children's services, tax reforms, and other economic concerns. Learn more about the points of view that other reformers advocate.
- *Cast positive messages.* Stay away from negative rhetoric. Research shows that the public is more likely to support changes presented in a positive light. Craft constructive messages based on the need for finance reform, not ones that blame particular individuals or agencies.
- *Use facts to support and justify a message.* Most audiences expect outside evidence to corroborate or further explain a point of view or claim. Draw upon information that supports a sense of urgency in addressing the issue.
- *Tap into the big-picture issues that people are talking about.* Show how changes in the finance and delivery of education and children's services address the concerns of friends, neighbors, and voters. For example, emphasize how improvements to finance systems will help to create more or better-paying jobs, curtail neighborhood crime, or provide ample opportunities for family self-sufficiency.

STRATEGY 3: INCREASE PUBLIC KNOWLEDGE AND UNDERSTANDING OF THE ISSUES

- *Develop succinct, quotable talking points that reinforce the message.* Concise and memorable phrases focus attention on the "guts" of an effective message. Succinct analyses also make it easier for reporters and editors, who work under daily time and space constraints, to capture the essence of the message.

Throughout the process of devising and tailoring the message, it is important to test and refine your approach so that the need for change is clearly communicated. In-person and telephone surveys and polls; focus groups; and panel discussions are among the techniques used to hone in on the strengths and weaknesses of messages. Experts at consulting firms or in the marketing and communications departments of most colleges and universities can offer guidance.

COMMUNICATING THE NEED FOR FINANCE REFORM: TIPS FOR TAILORING YOUR MESSAGE

When tailoring a message to a particular audience, consider the following pieces of advice to ensure that the message that reform is urgently needed gets communicated in a loud and clear manner:

- **Know the audience.** Learn more about the different groups of people who are potential stakeholders. Draw on research from polls, surveys, and focus groups to find out more about the priority needs of target audiences. Consider carefully what types of messages are well received by these groups, and use that knowledge to design an effective message.
- **Design messages to be clear, direct, and personal.** What is the message intended to make people do? What information will they need in order to act? Clarify why finance reform for education, health, and human services is important—even urgent—to all of the groups, not just those with immediate and obvious vested interests. Each of the vital parts of the constituency for reform has to be mobilized and has to understand how the change will affect them.
- **Use relevant "real-life" examples.** People respond favorably to anecdotes that mirror experiences from their own lives. Personal accounts that get right to the point of how finance system improvements affect individuals will build interest, provide unassailable testimony, and connect with people's common observations.

▼ Approach 3: Use Mass Media Effectively

One of the best ways to build public support is to communicate the need for change alongside other news and information that people rely upon in making decisions. News media help inform and influence all target audiences and offer the best opportunity to reach the most people at a given moment. Ongoing coverage can help sustain and reinforce a message, build momentum, and mobilize support for finance reform.

State and local leaders concerned about family and children's services can use media and public relations experts in order to increase public understanding of issues through a more traditional one-way approach to policy communications. One advantage of such an approach is that most political leaders are comfortable with it.[4] Various mediums also offer opportunities for two-way communications that build awareness and an urgency for change. For example, radio talk shows, public affairs programs, and teleconferences can all be used to communicate the need for change to the public in a more interactive—and often more comprehensive—manner.

When working with the media, those seeking finance system reform should keep the following tips in mind:

- *Be responsive to media needs.* The story that a news organization prints or broadcasts is shaped by the quality, reliability, and timeliness of information provided. Make it easier for reporters and editors to do their jobs and then they may be more likely to communicate the need and developing consensus for finance reform.

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- *Establish a rapport with people in the news media.* Try to keep relationships friendly and honest. This will help those seeking finance systems changes to feel at ease in dealing with reporters or editors, and will facilitate the development of a relationship of mutual trust and respect.
- *Designate one or two primary media liaisons.* They can facilitate the flow of information and alert reporters and editors to upcoming events, public meetings, and opportunities to cover public deliberation of finance reform. They can also handle media inquiries, or approach reporters and editors with new ideas.
- *Offer comment on related and breaking news stories that are tied to finance reform initiatives.* Volunteer to discuss the impact of a national story on the state or local area with the media. If a story breaks on the national level, identify an item in it that has local impact. Offer interviews, up-to-date information, and anything that can give a reporter a fresh angle.

▼ Approach 4: Take Advantage of New Communication Technologies

An emerging way to build awareness and heighten the sense of urgency for change is through new electronic communication technologies. The Internet—particularly the illustrated and easy-to-access World Wide Web—and other computer-based products allow those seeking to reform finance to reach a vast and diverse network of potential stakeholders. Currently, some 18 million households have a computer with the capacity to go on-line. And the number of new Internet and on-line users is estimated to grow by 10,000 users each day in the United States.[5]

Computer-based dissemination technologies allow state and local leaders to increase public understanding by permitting taxpayers, voters, and concerned individuals to explore materials on-line, or on diskette and CD-ROM, at their convenience. Potential stakeholders can digest the information at their own pace, taking in as much or as little detail as they wish. And posting information on the need and possible solutions for finance reform on the Web can be used to reinforce an open public engagement process, by allowing groups to host forums for sharing information, and taxpayers, voters, and others to easily download relevant data.

States and communities can use the information superhighway to supplement traditional media sources as a method for communicating news and information. In fact, many government agencies, national research organizations, and local community groups are creating Web home pages that serve as combination electronic brochure, billboard, and magazine. And two-thirds of the states have posted their budgets on the Internet, although most have not yet posted clear summaries such as popular reports (see below).

Those seeking to improve finance systems can also distribute computer diskettes or CD-ROMs to increase public awareness of finance information and facilitate discussion of the types of strategies or options that might be pursued to improve finance systems. California's experience provides one example of how this approach has been used. To heighten awareness of the state budget, state officials created a computer game that lets taxpayers and others examine and play with the tradeoffs necessary for a balanced state budget.

▼ Approach 5: Disseminate Relevant Written Materials Widely

Voters and taxpayers process information in a variety of ways. Some tune in to the daily news, while others plug in to the information superhighway. Many read written information or analyses. To reach these stakeholders, those seeking to reform finance systems for education and other children's services can prepare and distribute a variety of written materials in order to increase public understanding of the need for reform and the possible solutions.

One of the challenges to those seeking to improve state and local finance systems is to present materials on the need for reform in ways that are easy to understand and that underscore the importance of improvement. Multiple strategies can—and should—be pursued. To assist the public in learning about the issues, three approaches can be considered. They include: (1) developing short reports emphasizing key trends, (2) preparing targeted issue papers, and (3) issuing performance reports to focus attention.

▼ *Develop Short Reports that Emphasize Key Trends or Issues*

Short, popular reports can be useful in communicating the basics surrounding complex finance matters, such as how revenues are generated or how public dollars are allocated. By emphasizing key trends or important issues, they focus public attention on the issue in question. State and local leaders seeking to raise public understanding of finance issues should remember that many people find information that provides a context and linkage with surrounding areas—for instance, comparisons with similar and neighboring schools—to be more valuable than extensive, detailed information on a given subject.

One of the challenges to those seeking to improve state and local finance systems is to present materials on the need for reform in ways that are easy to understand and that underscore the importance of improvement.

State efforts to present complex budget information in ways that are more understandable to the public provide an example of attempts to build awareness by emphasizing key issues or trends. Popular budget reports build higher levels of public awareness because they are more user-friendly than traditional budget documents. By keeping the needs of target audiences in mind—for example, using tailored messages as focal points to lay out budget information—popular reports underscore the relevance of the issue for average readers. (See Chapter 3, *Budgeting Better*.)

▼ *Prepare Targeted Issue Papers*

Many states and localities use brief and clearly delineated issue papers in order to target their message to stakeholders. Issuing a series of interrelated analyses provides another method of simplifying the complex issues surrounding finance systems.

West Virginia's experience with targeted issue papers illustrates their potential effectiveness. When West Virginia launched an education reform initiative several years ago, policymakers created a series of brief issue papers for a group of primary stakeholders selected as an advisory committee to the process. The papers divided the broad range of issues into more manageable parts, while still maintaining the connections between them. By focusing attention on the nature of the problem and making the case for its urgency, the papers successfully drew a broader circle of stakeholders into further discussion about options for change.

As with other analyses, it is important that issue papers communicate the benefits of change, as well as any strengths of the current system. Finance mechanisms and programs serving families and children often have evolved to their current form because they provided benefits for a group or groups of people. If issue papers are skewed with too heavy a focus on what is not working, such groups may be offended and develop strong resistance to reform. Alternatively, if analyses focus on improvements and give credit for work already done, they will be more likely to build broader support.

▼ *Issue Performance Reports to Focus Attention*

Performance reporting is another way to increase public understanding of financing for family and children's services. While performance reporting is often seen as a way to evaluate success after a reform has been initiated, it can also help to build awareness, urgency, and public support for change. Performance reports can effectively communicate the need for reform–and even mobilize resources into action–by drawing attention to how a given state or community's efforts to educate, nurture, and care for its children measure up against various indicators. The common yardsticks used to measure performance include predefined goals and objectives, or comparisons with other states and communities. (See Chapter 3, *Budgeting Better.*)

FOCUSING PUBLIC ATTENTION THROUGH A GOALS PROCESS SUPPORTED BY PERFORMANCE MEASUREMENT AND REPORTING

The National Education Goals Panel offers guidance to those at the state and local levels who want to engage citizens in activities to set and achieve education goals. Similar steps can be applied to improve finance systems for other children's services, such as health or child care. The Panel outlines a "Goals Process," which focuses on performance measurement and popular reporting to stimulate reform. In order to improve finance systems for children, state and local leaders should take the following steps:

- **Adopt goals** that reflect high expectations for all children and cover the entire breadth of focus from prenatal care to lifelong learning and opportunity.
- **Build a strong accountability system** to regularly measure and report on progress towards the goals over time, assessing the strengths and weaknesses of the current system.
- **Set specific performance benchmarks** to mark progress along the way and guide the change process.
- **Identify barriers and opportunities** for goal attainment in the many systems–particularly finance systems–that support children and families.
- **Create and mount strategies** to overcome the barriers to financing education and other children's services, to seize opportunities, and to meet performance benchmarks.
- **Make a long-term commitment** to continuously re-evaluate accomplishments and shortcomings in meeting community goals, and be willing to modify strategies as needed.

The education report cards issued by many states and school districts provide a well-known example of a common performance report. Most performance reports communicate information on how a local school or district measures up on various indicators of performance that are important and relevant to members of the state or community. As discussed in the accompanying box, performance reports are critical ingredients in the process of developing support for broad changes in education reform.

Perhaps the best-known examples of performance reporting can be seen in Oregon and Minnesota. The *Oregon Benchmarks* and *Minnesota Milestones* establish quantifiable long-term goals along with the targeted milestones or benchmarks to achieve along the way. The reports set the stage for discussion of management and finance changes that must be made in order to realize state goals. Both have major sections devoted to improving conditions of families and children.

STRATEGY 4: CREATE OPPORTUNITIES FOR PUBLIC DELIBERATION

Creating adequate time and space for public deliberation is needed in order to build a broad base of support for reform. Once the urgency of an issue has been communicated to the public, research shows that the public tends to rush in with immediate and often ill-considered responses. Allowing sufficient time and opportunities for deliberation helps to develop more thorough and comprehensive plans for change.

Once communications have helped to raise consciousness, work still needs to be done to convert the public's free-floating concern about the need to "fix the problem" into support for specific proposals to improve finance systems. Because taxpayers, voters, and others are eager to find answers quickly, they typically settle on a preliminary point of view without fully realizing the implications of this particular choice or the range of alternatives for consideration. Despite initial leanings toward various positions, most people aren't ready to zero in on specific solutions when they first become aware of a problem and its urgent need for resolution. They must first come to grips with the consequential costs and risks associated with each proposal.

As a result, policymakers and advocates of finance reforms need to provide opportunities for deliberation which allow the public to: (1) deal with resistance and internal conflicts, and (2) identify and select the most appropriate option for reforming finance systems. These occasions will allow the public to consider the issues and their relationships to other issues, and to consider and select the most appropriate method for reforming finance systems from among the range of available options.

THE IMPORTANCE OF ENGAGING THE PUBLIC IN CHOOSING OPTIONS: SOME LESSONS LEARNED

Recent unsuccessful attempts to enact broad reforms in health care and tax systems—both at the federal and state levels—provide valuable lessons on the danger of issuing unrealistic appeals for change. When complex issues are addressed in a simplistic fashion, the public is inclined to support reforms that it will later find unattractive. Among the lessons learned were:

- Apparent support for change may dissolve as plans unfold and people learn more about the specific details of actually accomplishing reforms.
- The public may recoil from a particular initiative when faced with a slew of previously unconsidered negative consequences, as well as real problems of design and implementation.
- Support can erode and eventually disappear, or even change to active resistance.

▼ Approach 1: Deal with Resistance and Value Conflicts

As efforts to engage the public in finance reform proceed, resistance to specific proposals invariably sets in. Traditional theory suggests that when resistance surfaces, those seeking change should provide more information, call in the public relations experts, and put the "proper spin" on the issue in an attempt to persuade.

But traditional methods do not resolve the fundamental tensions among conflicting values that fuel resistance to change. Often, the difficulty with finding a common solution is not simply that different people hold conflicting values; rather, it is that the same people often hold opposing values at the same time. Thus, policymakers, political leaders, and advocates of finance reform should try to surface resistance by identifying and bringing conflicts into the open and creating favorable conditions for public resolution to occur.[6]

In education and other children's services, value conflicts may be linked to deeply held beliefs about the appropriate roles and responsibilities of families and of government. For example, many people may be torn between the feeling that the public should provide supports and services for children, and the belief that the public sector should stay out of the lives of families.

People construct other barriers that make it difficult to communicate change. In particular,

- *People may confront issues with wishful thinking:* e.g., "If we got rid of all the waste, fraud, and abuse in the welfare program, we would save enough money to cut taxes without abandoning poor kids."
- *People often misunderstand proposed reforms*: e.g., "Why is the school board pushing for an increase in the property tax millage? I thought money from the new state lottery was covering school costs."
- *Individuals have personal reasons to resist change:* e.g., "If the state puts that new juvenile detention center in our neighborhood, it's going to lower the value of my house and threaten the safety of our community."
- *People tend to view issues in a compartmentalized way*: e.g., "The county is floating a measure to fund immunization for all preschoolers—even for kids whose parents came to this country illegally. I don't see what measles has to do with math. And I don't see why my tax dollars should pay for services to illegal immigrants."

There are several ways that leaders can help the public move beyond the first response and resolve internal conflicts. First, they can frame issues in order to invite public discussion and discovery. Second, they can provide forums to give people the time and space they need in order to learn about the problems and identify value conflicts that impede change.

INSUFFICIENT TIME FOR PUBLIC DELIBERATIONS LEADS TO WEAK SUPPORT FOR CHANGE: THE CASE OF NEW JERSEY

The Need for Finance Change

In 1989 the New Jersey Supreme Court ruled that the state's school funding law was unconstitutional. In response, the state passed the Quality Education Act, which dramatically reshaped the method for financing education within the state.

A Quick Response that Lacked Public Input

Eager to enact bold changes, the state passed the law quickly without allocating sufficient time to explain the legislation, make sure that the public understood all of its components, and build support for passage and implementation. Adverse public reaction to the measure led to extensive changes shortly before the law was to take effect.

Short-Lived Success

Reflecting on the process, many observers concluded that the initiative moved from proposal to law too fast, because the revised law was later declared unconstitutional.

STRATEGY 4: CREATE OPPORTUNITIES FOR PUBLIC DELIBERATION

▼ *Frame Issues to Invite Public Discussion*

Just as those wishing to reform education and other children's services need to consider how to best frame issues in order to secure political commitment, they also need to identify principles that set an inviting tone and clarify the context of finance reform for the general public. Statements of the need for change should address different stakeholder concerns, and to help surface underlying value conflicts that contribute to resistance.

FRAMING THE ISSUE: THE IMPORTANCE OF PICKING A WINNING FOCAL POINT

The Need for Change

In the early 1980s, policymakers in many southern states saw a clear and pressing need for comprehensive changes in education and training systems, coupled with substantial tax increases to pay for improvements.

Repeated Attempts Failed to Stimulate Interest in Reform

Citizen concerns about education reform in many communities focused on government spending (that is, whether to invest more or less money). Others saw the issue divided along racial lines (for example, whether more money should be spent to support minority children who remained in the public system as white families migrated to private schools).

Kentucky's Winning Focal Point

Education reform advocates in Kentucky chose a different focal point. They cut across racial lines and moved beyond the no-win focus on higher government spending by framing the concept of education reform as the cornerstone of economic development and competitiveness. By linking school improvement with public concerns about jobs, productivity, and opportunity, policymakers won support for the first tax increase in Kentucky's recent history.

To frame these issues effectively:

- *Learn more about common misperceptions in order to confront wishful thinking.* Understand the personal implications that cause people to stop in the tracks of change.
- *Broaden public understanding of finance reform* in ways that underscore the benefits to individuals and to society as a whole. Show the connections between the ways that family and children's services are financed, and other issues important to stakeholder groups, such as tax relief, healthy children, and well-educated citizens.
- *Give the public a sense that there is something they can do* to handle the complex problems associated with financing and delivering quality services for children.

▼ *Create Forums for Discovery and Dialogue*

Political leaders and advocates of finance reform for education, health, and human service systems can focus public attention on these issues by organizing forums that help the public in its search for new finance methods. Providing time to consider, discuss, and understand the issues inherent in finance reform and to surface conflicts of value and opinion is one of the most essential ingredients in building lasting support for change. But this deliberative process is almost totally absent from life in America today, due partly to the dominance of the traditional model of public communication.[7]

State and local leaders interested in finance reform should consider different types of forums to allow the public to explore their alternatives, including:

- Focus groups and discussion sessions with legislators, executive branch officials, community leaders, and representatives of interest groups.
- Town meetings in places that are convenient and accessible. These events may be large or small. They may be hosted by a government agency, or coordinated by other groups with the support of political leaders and public policymakers.
- On-air forums hosted by local radio and TV stations. If resources allow, two-way teleconferences that link people in discussions via satellite can be convened.

For these forums to be effective, it is critical that they provide an opportunity for all those with concerns to voice their questions or reservations. To facilitate this exchange, select skilled, respected moderators and group facilitators whom the public trusts and considers objective. Make sure that the moderators provide ample opportunity for concerned individuals—both vocal, active participants and those traditionally less engaged—to talk about the concerns that finance reform raises. These forums can provide good opportunities to tease out underlying value conflicts.

These kinds of events also afford opportunities to involve political leaders, thereby demonstrating their support for the process and maintaining their political connections to the final product. But make sure that political leaders are clear as to the purpose of the forums—to help people work through the many issues related to financing family and children's services, not to press for final decisions.

[illegible]

PRINCIPLES CAN FOCUS FINANCE REFORM DELIBERATIONS TO IMPROVE EDUCATION AND OTHER CHILDREN'S SERVICES

When bringing together diverse stakeholders to work through the process of cementing the need for reform and selecting strategies to achieve it, common objectives can help to focus what can otherwise be a non-productive discussion. These objectives help to channel the energies of different stakeholders in fruitful ways. This process has been used in many states and communities, including:

- **Ohio,** where an interagency team supported by the Governor developed a set of principles to involve the public. The team asked stakeholders in family and children's services at the county level to begin to identify what an effective service delivery system should look like. Finance mechanisms surfaced as a top concern, integrally intertwined with issues of quality service delivery. Using this approach, policymakers framed the issues and fostered an environment ripe for public action.
- **Pennsylvania** through the *Family Center Program* articulated a set of principles, which the state asked county providers to use in changing the delivery, management, and financing of family and children's services. State representatives are meeting with local groups who are interested in developing collaborative approaches to explore ideas, clarify principles, and continue public dialogue.

▼ Approach 2: Focus Attention on Developing and Making Choices

After searching for answers, the taxpayers, citizens, and others concerned about education, health, and human services are ready to weigh the pros and cons of different options and then to make decisions about proposed changes for financing these services. Called "choicework" by some public opinion experts,[8] the process of assessing the advantages and disadvantages of different choices is not unlike the one that policymakers go through to make decisions.

To ensure lasting support for changes state and local leaders must encourage different stakeholders and the general public to invest the effort to grasp the options; consider the costs and implications of each; wrestle with tradeoffs; and resolve the value conflicts that choice entails. Creating opportunities that encourage the public to grapple with the choices involved can facilitate this process. Thus, finance reform advocates should consider convening town meetings or community events, and holding focus groups and discussion sessions during this phase as well.

Those wishing to reform finance systems must realize that the purpose of the encounters is decidedly different from that of exploratory deliberation, however. In this case, policymakers, political leaders, and advocates of finance reform are trying to help the public grapple with and make difficult choices. As a result, these exchanges may require a different set of leadership tasks.[9] To assist the public in choosing a viable strategy, those interested in reform can:

- *Provide a range of choices, including middle-of-the-road options.* Although reform leaders may find some options more desirable than others, it is important to present a range of options for public discussion and consideration. Because economic, political, administrative, and other realities exist, middle-of-the-road options are also important.
- *Define choices in the public's terms, not those of the experts.* Get rid of jargon! It sends people the message that "non-experts don't belong here." If a message can't be communicated in plain English, more work refining the message needs to be undertaken.
- *Focus attention on the difficult tradeoffs, costs, and sacrifices.* To make a sacrifice ungrudgingly, the public must understand its rationale, and they must have some say in the types, forms, and conditions of sacrifice they are asked to make.[10]

As when helping the public to deal with resistance and conflicting values, it is important to allocate sufficient time for decisionmaking. The process of weighing the pros and cons of different solutions cannot be rushed. While those seeking reform may be working under real-time constraints, it is absolutely essential that policymakers and political leaders give the public enough time to

INVOLVING POLITICAL LEADERS IN PUBLIC DELIBERATIONS: AN EXAMPLE FROM WEST VIRGINIA

Finance reforms that build political support and also engage the public are likely to be the most long-lasting. Forums for public deliberations provide valuable opportunities to involve key groups in making the needed improvements. In West Virginia, for example, Governor Gaston Caperton used the choicework process to advance statewide education reform by:

- Organizing and participating in town meetings, providing citizens with a range of options to consider;
- Structuring time for discussion and the promotion of a deeper public understanding of the issues—making sure to focus public attention on the consequences associated with different policy options; and
- Investing appreciable time in listening, learning, and personally following up with people who attended decisionmaking forums.

The Governor's involvement had a number of important consequences. Not only did it elevate awareness of the issues by encouraging voters and concerned citizens to play a more active role in the deliberations themselves, but it also demonstrated the Governor's commitment to act on priorities charted by the electorate.

consider options. Forcing the public to rapidly select options may jeopardize the success of the entire reform effort.

In addition, those seeking to improve education, health, and human service finance systems in order to better serve children and families must provide incentives for the public to become involved. People will not invest the necessary time and effort to make a choice if they believe that their views will not be taken into account by national, state, or community leaders. Thus, reform leaders need to be as accessible as possible throughout the decisionmaking period.

STRATEGY 5: CRYSTALLIZE COMMITMENT TO CHANGE

After a preferred method of improving finance systems has been selected, those seeking change must build resolution and commitment to change. Only after people agree on the necessity of change can they make responsible judgments with moral, emotional, and behavioral implications that they are prepared to accept. "People form a resolution first in their heads; it takes a while for their hearts and consciences to catch up."[11]

During the period of intellectual resolution, voters, taxpayers, and parents clarify fuzzy thinking; reconcile inconsistencies; consider relevant facts and new realities and grasp the full consequences of choices. Emotional resolution requires stakeholders to confront their own ambivalent feelings, accommodate themselves to unwelcome realities; and overcome the urge to procrastinate.[12]

There are several ways that leaders can help crystallize public support for finance reform and turn changes in attitude towards changes in behavior. They can: (1) publicize an emerging consensus, (2) solidify support, (3) celebrate results, and (4) involve the public in enacting change.

Only after people agree on the necessity of change can they make responsible judgments with implications that they are prepared to accept.

▼ Approach 1: Publicize Emerging Consensus

Drawing attention to the emerging consensus for improvements to the finance system can help move the public from resolution to action. Multiple strategies should be used to ensure that the message gets out. Those seeking finance reform can:

- Take continuous advantage of traditional media relations tools to tell the story. If members of the media have been treated as stakeholders in the process—having participated throughout and reached their own level of informed opinion—then they are likely to report on the emerging consensus and offer editorials that build further support.
- Write articles, letters to the editor, and feature stories for reprint in newspapers, newsletters, and trade journals. Also circulate materials to non-print media, such as television and radio broadcasters.
- Work with special-interest media (such as magazines, TV, or radio programs directed to women, families, the elderly, or urban dwellers) and Internet communications—both of which target active, self-selected information consumers.

When publicizing the emerging consensus, state and local leaders should be sure to emphasize the collective role of political, business, and community leaders in identifying a mutually agreed-upon strategy for change.

▼ Approach 2: Solidify Support

To move from resolution to reform, those seeking reform need to solidify their support among the public and its leaders, including elected officials, business executives, and other leaders. Taking the time to secure additional support from those who may have not been integrally involved in the decisionmaking and deliberation processes will facilitate implementation in the future.

To solidify support, identify, earn, and publicize endorsements from individuals and groups who can influence segments of the population who may not have made up their minds about how finance systems should be changed. Review the list of stakeholders and ask them to communicate their points of view through every available medium.

Endorsements made by groups may be especially valuable, because they have great potential to further reform efforts. This proved to be the case in San Francisco's 1991 campaign to fund children's services through Proposition J. The group spearheading the campaign, Coleman Advocates for Children and Youth, found endorsements of clubs and organizations to be far more important in solidifying support than those from individuals. The groups communicated their official positions to their memberships, which increased support enormously.[13]

Another strategy to solidify support for finance reform is to continue to help people make important connections between issues that they may not make on their own. These connections will help to build commitment by reinforcing the positive gains from proposed change. To make these connections, incorporate within the frame of finance reform new issues that move high on the list of public priorities. And focus attention on the broader social and economic goals to be achieved by reforming finance systems for education, health, and human services.

Finally, involve mediating institutions—"key places where people come together to talk and act on public concerns"[14]—in efforts to solidify support. These organizations can provide a context, a place, and the person-to-person backup to help people act on their ethical judgments. Often, encouraging individuals to put ethical commitments ahead of their personal needs can cement support for reform. Examples of mediating institutions are places of worship, schools, or neighborhood organizations. These institutions can be quite effective in translating initial acceptance into full commitment.

▼ Approach 3: Celebrate Results

Celebratory gatherings of major stakeholders call attention to the selected reform, as well as energize individuals to take the next steps for reform. Celebrations serve as important opportunities to acknowledge and pay tribute to the individuals and organizations whose hard work on behalf of a reform effort helped to move the issue forward.

Coordinating celebrations with efforts to publicize the emerging consensus for reform can have significant benefits. To increase participation, draw upon the ability of political and other leaders to attract media attention and increase public participation in celebratory events.

When planning an event to celebrate the selection of an option, make sure to invite all those who may have been important in furthering the reform effort. For

SAN FRANCISCO'S EMERGENCE AS A "PRO-CHILD" CITY: A GOOD CELEBRATION TO BRIDGE THE GAP

In November 1991, San Francisco's voters enacted Proposition 1, amending the city charter "to mandate that 2.5 percent of the property tax be set aside to expand children's services each year—eliminating annual budget battles and creating a kind of fiscal bill of rights for children."

When the measure passed, Coleman Advocates for Children and Youth which led the spirited drive, joined with city officials to celebrate the establishment of San Francisco as a "pro-child" city.

Even those who had opposed the initiative were invited, which helped reunite elements of the community split by the referendum campaign.

Source: Brodkin, Margaret, *From Sand Boxes to Ballot Boxes, San Francisco's Landmark Campaign to Fund Children's Services.*

example, if the impetus for reform came from within government, extend the celebratory net to include all those who participated in it and even those who opposed it. Similarly, if the reform effort started outside of government but resulted in legislation, include government leaders and allow all who want to claim credit to do so.

▼ Approach 4: Involve the Public in Enacting Change

After communicating the need for change and earning public commitment to act, don't forget to tell people what they can actually do! This seems obvious. But many leaders often neglect to clarify ways in which people can direct their interests and energies to implement change. Don't fall into the trap of building interest and commitment for finance reform without providing channels in which the public can direct their support. Make sure that people understand what they can and should do.

Consider the old story of the candidate for political office who campaigned hard, and won widespread public support for her platform, but did not succeed at getting voters to take a very specific action—going to the polls and voting for her on Election Day. She may have changed public attitudes, but her campaign failed to mobilize action.

In order to capitalize on the energies and talents of the supporters of reform, state and local leaders should let people know how they can help. This information should be as specific as possible. For example, by identifying individuals, organizations, or agencies that welcome assistance, supporters can direct their energies in the most productive ways. Providing phone numbers, addresses, and names whenever possible is also helpful. Finally, when soliciting help, suggest a range of activities—some for those with little time and some for those who can devote more attention or personal resources.

SUMMARY

Policymakers and leaders interested in finance reform for family and children's services should start with the joint assumptions that they will need political support and that people want to be involved—particularly as competition for resources becomes more intense. Policymakers should also recognize that taxpayers are becoming more sophisticated and demanding as they place increasing expectations on government to improve performance. Improved performance requires that organizations maintain close contact with the children and families they serve, and engage them in change. New and emerging technologies exist to support a process of public engagement. But these changes portend new roles for public officials and taxpayers alike.

State and local leaders interested in finance reform should pursue multiple strategies to build the necessary political and public support. Laying the groundwork for reform is an important precursor to many of these steps. Those seeking reform need to define the need for reform clearly in order to illuminate the urgent need to take action. Assessing the environment for reform—the political, economic, and other contextual conditions—can help or hinder the success of reform efforts. And identifying a small team of leaders and stakeholders can help in crafting effective messages and charting initial strategies.

Enlisting political leaders who have demonstrated an interest in improving education, health, or other children's services to champion the initiative brings visibility to the reform effort and can have other important benefits. Thus, reformers should carefully consider which leaders can serve as effective spokespersons to champion the effort. Finding ways to develop political strategies and maintain political will is also crucial.

Raising public awareness and knowledge of the need to improve finance systems—revenue systems, budgeting practices, intergovernmental grants, public-private partnerships, or financial and other incentives—requires state and local leaders to communicate the urgent need for improvement. Messages need to be carefully crafted, and, where appropriate, tailored to grab the attention of various stakeholders. Since the public gathers and assimilates information from a variety of sources, multiple communication strategies can—and should—be pursued to heighten awareness. Options include: using traditional news and print media, posting material on the World Wide Web, and disseminating short reports, targeted issue papers, and other written materials.

Providing opportunities for the public to deliberate and wrestle with the tradeoffs involved in choosing the most appropriate option is a key component to an effective public engagement strategy. Committing to the need for reform and selecting among the available options and strategies requires time, space, and neutral guidance for the public to work its way through options. Creating opportunities for the public to deliberate on the issues and hold interactive dialogues with policymakers and reform leaders builds support by forcing stakeholders to confront wishful thinking, reconcile value conflicts, weigh options, and select directions for reform.

Once the public and its leaders have indicated their preferences, state and local leaders need to take actions to crystallize commitment to finance reform. Various approaches can be employed, including: publicizing the emerging consensus through the media; using mediating institutions such as churches to solidify support; and convening stakeholders to celebrate results.

Throughout the process of building support, leaders may encounter enormous challenges. They need to remain patient, however, because it takes time to engage people in decisionmaking. The amount of time required will vary, depending the political climate; complexity of issues; numbers of stakeholders and players involved; and the degree to which leaders are committed to public engagement, as opposed to public persuasion. But the investment of time pays off in the form of solid and longer-lasting support for finance reform.

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2 Daniel Yankelovich, *The Rules of Public Engagement*, p. 6.

3 Campaign for Fiscal Equity, *Fair Funding for Quality Education*, New York.

4 Daniel Yankelovich, *The Rules of Public Engagement*, p. 5.

5 Carnegie Corporation, "Learning in the Electronic Playground," *Report of the Carnegie Task Force on Learning in the Primary Grades*, June 5, 1996 draft, p. 6.

6 Daniel Yankelovich, *The Rules of Public Engagement*, pp. 9-12.

7 Ibid., p. 12.

8 Ibid., p. 12.

9 Ibid., pp. 13-14.

10 Daniel Yankelovich, "How Public Opinion Really Works," *Fortune*, October 19, 1992, reprinted with permission in *Communicating Change: Engaging the American Public in Education Reform, A Day-Long Workshop for Community Leaders*, Public Agenda, 1992.

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12 Daniel Yankelovich, "How Public Opinion Really Works."

13 Margaret Brodkin, *From Sand Boxes to Ballot Boxes, San Francisco's Landmark Campaign to Fund Children's Services*, Coleman Advocates for Children and Youth, 1994, p. 39.

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Who to Contact for More Information

The Business Roundtable, 1615 L Street, NW, Washington, DC 20036, (202) 872-1260.

Council of Chief State School Officers, One Massachusetts Avenue, NW, Suite 700, Washington, DC 20001-1431, (202) 336-7015.

Council of Governors' Policy Advisors, 400 North Capital Street, NW, Suite 390, Washington, DC 20001, (202) 624-5386.

Council of Great City Schools, 1301 Pennsylvania Avenue, NW, Suite 700, Washington, DC 20001-1431, (202) 393-2427.

Education Commission of the States, 707 17th Street, Suite 1700, Denver, CO 80202-3427, (303) 299-3600.

The Harwood Group, 4915 St. Elmo Ave., Suite 402, Bethesda, MD 20814, (301) 656-3669.

National Conference of State Legislatures, 1560 Broadway, Suite 700, Denver CO 80202, (303) 830-2200.

National Education Goals Panel, 1255 22nd Street, NW, Suite 502 Washington, DC 20037, (202) 632-0952.

National Governors' Association, 444 N. Capitol Street, NW, Washington, DC 20001-1512, (202) 624-5300.

The Public Agenda Foundation, 6 East 39th Street, New York, NY 10016-0112, (212) 686-6610.

U.S. Chamber of Commerce, Center for Workforce Preparation, 1615 H Street, NW, Washington, DC 20062, (202) 463-5525.

United Way of America, 701 N. Fairfax Street, Alexandria, VA 22314-2045, (703) 836-7100.

For More Information on Examples Provided in the Text

Coleman Advocates for Children and Youth, 2601 Mission Street, Suite 804, San Francisco, CA 94110, (415) 641-4362.

Ohio Family and Children First Initiative, Office fo the Governor, 77 South High Street, 30th Floor, Columbus, OH 43266, (614) 728-9423.

Oregon Progress Board, 775 Summer Street, NE, Salem, OR 97310, (503) 986-0039.

Pennsylvania Department of Education, Division of Early Childhood and Family Education, Family Center Program, 333 Market Street, Harrisburg, PA 17126-0333, (717) 783-6788.

West Virginia Education Reform Process, Office of the Governor, State Capitol Building, Charleston, WV 25305, (304) 558-2000.

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